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TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1935

No. 226

MANHATTAN GENERAL EQUIPMENT COMPANY,
PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

PETITION FOR CERTIORARI FILED JULY 8, 1935.

CERTIORARI GRANTED OCTOBER 14, 1935.

SUPREME COURT OF THE UNITED STATES

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JUDD & DETWEILER (INC.), PRINTERS, WASHINGTON, D. C., Nov. 14, 1935.

—7115-C

[fol. 1]

BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket No. 51345

MANHATTAN GENERAL EQUIPMENT CO., Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

DOCKET ENTRIES

APPEARANCES:

For Petitioner: Laurence Graves, Esq., A. M. Kracke, Esq.

For Respondent: W. F. Gibbs, Esq.

Transferred to Mr. Murdock.

1930.

Dec. 17. Petition received and filed. Taxpayer notified. Fee paid.

" 17. Copy of petition served on General Counsel.

1931.

Feb. 10. Answer filed by General Counsel.

" 17. Copy served—assigned General Calendar.

1932.

Oct. 5. Hearing set November 15, 1932.

" 22. Motion for 60 days continuance filed by taxpayer. October 25, 1932 granted to January 16, 1933.

1933.

Jan. 16. Hearing had before Mr. C. R. Arundell, Division 7. Submitted on merits. On petitioner's motion, consolidated with 51,346 to 51,380 (except 51,362 and 51,371). Oral amendment made to petition. Stipulation of facts filed. Briefs due March 15, 1933.

[fol. 2]

Jan. 23. Transcript of hearing January 16, 1933 filed.

Mar. 6. Motion for extension of 30 days to file brief filed by taxpayer. March 7, 1933 granted.

" 15. Brief filed by General Counsel.

Apr. 15. Motion for extension of 30 days to file brief filed by taxpayer. April 15, 1933 granted to both parties.
May 13. Brief filed by taxpayer.
Nov. 23. Opinion rendered—J. E. Murdock, Division 3. Decision will be entered under Rule 50.

1934.

Mar. 15. Stipulation as to deficiency filed.
" 20. Decision entered—J. E. Murdock, Division 3.
June 1. Motion to fix amount of bond filed by taxpayer.
" 2. Order fixing amount of bond at $1,300 entered.
" 20. Petition for review by United States Circuit Court of Appeals, Third Circuit, with assignments of error filed by taxpayer.
" 20. Proof of service filed by taxpayer.
Aug. 7. Præcipe with proof of service thereon filed.
" 18. Order extending time for transmission and delivery of record to September 10, 1934 entered.

[fol. 3] BEFORE UNITED STATES BOARD OF TAX APPEALS

[Title omitted]

PETITION—Filed Dec. 17, 1930

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency IT:AR:A-5-HGF-60D, dated October 21, 1930, and as a basis for this proceeding alleges as follows:

1. The petitioner is a corporation organized under the laws of the State of New Jersey with principal office at 220 West 42nd Street, New York, New York.

2. The notice of deficiency (a copy of which is attached hereto and marked Exhibit A) was mailed to the petitioner on October 21, 1930.

3. The taxes in controversy are income taxes for the calendar years 1925 and 1926 and in the respective amounts of $564.80 and $333.79.

[fol. 4] 4. The determination of tax set forth in the said notice of deficiency is based upon the following errors:

(a) In the determination of the net income of Artemas Ward, Inc., a New York corporation, for the year 1925 as well as the consolidatd net income, the total tax of the consolidated group and the proportion of such tax to be assessed upon the petitioner, the respondent has failed and refused to allow a deduction for the exhaustion of the March 1, 1913, fair market value or of the cost of a contract with the Interborough Rapid Transit Company in an amount not less than $63,749.40.

(b) In the determination of the net income of Artemas Ward, Inc., a New York corporation, for the year 1925 as well as the consolidated net income, the total tax of the consolidated group and the proportion of such tax to be assessed upon the petitioner, the respondent has failed and refused to allow a deduction for a loss sustained by reason of the cancellation of the contract with the Interborough Rapid Transit Company in an amount not less than $605,619.30, representing the unexhausted portion of the March 1, 1913, fair market value or of the cost of said contract.

(c) In the determination of the net income of United Brokerage Company, a Delaware corporation, for the year 1926 as well as the consolidated net income, the total tax of the consolidated group and the proportion of such tax [fol. 5] to be assessed upon the petitioner, the respondent has failed and refused to allow a deduction for losses sustained by reason of sales of the capital stock of Artemas Ward, Inc., a New York corporation, in the aggregate amount of $3,062,314.54. The aggregate amount allowed by the respondent on account of these losses is $495,696.76.

(d) In the determination of the net income for the year 1925 of the corporations hereinafter listed in this assignment of error, the respondent has failed and refused to allow deductions on account of the net losses of such corporations for the years 1923 and/or 1924, said net losses having been computed in the amounts set oposite their respective names, and the respondent has also erred in the determination of the consolidated net income, the total tax of the consolidated group, and the proportion of such tax to be assessed upon the petitioner, by reason of his failure to allow deductions on account of such net losses.

Name	Year 1923	Year 1924
United Brokerage Company (Del.)	$ ——	$207,799.89
Street Railways Advertising Company (Del.)	——	11,577.84
Street Railways Advertising Company (N. Y.)	55,190.96	27,660.81
Broadway Subway Advertising Co., Inc		175,003.34
Mark D. Batch der Company	5,495.80	——
(Motor Coach Advertising Service, Inc. (Md.)		11,934.84
*(Bus Advertising Service, Inc. (Md.)	13,220.83	
(Motor Coach Advertising Service, Inc. (N. Y.)		
[fol. 6]		
*(Bus Advertising Service, Inc. (N. Y.)	7,102.65	7,193.09
A. H. Armstrong Company	——	867.42
Iroquois Advertising Company	1,521.96	——
Transit Sales Corporation	13,405.53	3,146.12
Standard Vending Corporation	5,881.28	8,849.9a
*(Advertising Samplers, Inc	26,149.75	17,342.84
(National Vending Service, Inc	5,508.19	2,721.13
Interstate Sales Company	33,199.51	2,223.22
De Soto Paint Manufacturing Company	16,254.12	9,324.34
Quincy Warehouse Company	58,800.58	304,425.11
*(The Florida Railroad and Navigation Corporation.		
(Florida Hotel and Navigation Company	32,126.03	42,396.78
Florida Gulf Coast Hotels, Inc	——	2,029.79
Alexander, Ramsey & Kerr, Inc		2,755.56
(Island Realty Company	650.33	
*(Island Investment Company	216,553.75	38,469.57
Deep Lake Company		
(Neighborhood Stores Display Service, Inc	10,429.84	6,843.29
*(Manufacturers Display Service Corp	53,711.58	43,392.89
Universal Vending Service Company	263,118.48	——
Luna Amusement Company	5,894.32	——
Crazy Village Amusement Corporation	17,406.03	——
Harum Scarum Amusement Corporation	1,710.37	7,117.19
Lee County Land Company	207.81	——
Gulf Coast Realties Corporation	687.32	4,321.32
Florida Timber Lands Corporation	2,489.84	——
The Barfield Company		26,117.20
Florida Development Company		7,615.04
Inter County Telephone & Telegraph Company		

* Change of name.

[fol. 7] (e) In the determination of the net income for the year 1926 of the corporations hereinafter listed in this assignment of error, the respondent has failed and refused to allow deductions on account of the net losses of such corporations for the years 1924 and/or 1925, said net losses having been computed in the amounts set opposite their respective names, and the respondent has also erred in the determination of the consolidated net income, the total tax of the consolidated group, and the proportion of such tax to be assessed upon the petitioner, by reason of his failure to allow deductions on account of such net losses.

Name	Year 1924	Year 1925
United Brokerage Company (Del.)	$207,799.89	$237,982.09
Street Railways Advertising Company (N. Y.)	27,660.81	14,925.62
Broadway Subway Advertising Co., Inc	175,003.34	——
Mark D. Batchelder Company	——	1,294.66
Motor Coach Advertising Service, Inc. (Md.)	11,934.84	37,752.08
(Motor Coach Advertising Service, Inc. (N. Y.)		12.15
*(Bus Advertising Service, Inc. (N. Y.)	7,193.09	
A. H. Armstrong Company	867.42	1,415.64
Iroquois Advertising Company	——	1,294.30
Transit Sales Corporation	3,146.12	2,405.25
Standard Vending Corporation	8,849.95	8,369.19
(Advertising Samplers, Inc		25,195.03
*(National Vending Service, Inc	17,342.84	
Interstate Sales Company	2,721.13	1,922.11
Bus Advertising Service, Inc. (Del.)	——	280.83
Quincy Warehouse Company	9,324.34	3,499.48
[fol. 8]		
The Florida Railroad and Navigation Corporation	304,425.11	278,038.98
Florida Gulf Coast Hotels, Inc	42,396.78	54,536.64
Island Realty Company	2,755.56	570.29
Deep Lake Company	38,469.57	21,397.04
Advertising Service Corporation	——	32.
(Neighborhood Stores Display Service, Inc		6,330.38
*(Manufacturers Display Service Corp	6,843.29	
Northwestern Advertising Company, Inc	——	31,783.35
Universal Vending Service Company	43,392.89	38,216.45
Crazy Village Amusement Corporation	——	7,580.15
Witching Waves Company	——	4,151.49
Harum Scarum Amusement Corporation	——	1,012.96
Lee County Land Company	7,117.19	74,069.56
Gulf Coast Realties Corporation	——	20,932.37
Florida Timber Lands Corporation	4,321.32	78,417.58
The Barfield Company	——	8,864.aa
Florida Development Company	26,117.20	21,031.34
John Weiss, Inc., Photographers	——	118.31
Inter County Telephone & Telegraph Company	7,615.04	23,824.79
Everglades Publishing Company	——	2,433.34
Times Square Utilities Company, Inc	——	1,838.57

* Change of name.

(f) In the determination of the net income for the years 1925 and 1926 of the corporations hereinafter listed in this assignment of error, the respondent has failed to allow deductions on account of franchise taxes accrued within such years under the taxing statutes of the State of New York in the amounts set opposite their respective names and the respondent has likewise erred in the determination of the consolidated net income, the total tax of the consolidated [fol. 9] group, and the proportion of such tax to be assessed upon the petitioner, by reason of his failure to allow deductions on account of such franchise taxes.

Name	Year 1925	Year 1926
Barron G. Collier, Inc. (N. Y.)	$47,332.38	$2,803.22
Street Railways Advertising Company (N. Y.)	15.00	15.00
Empire State Advertising Company	155.93	25.00
Motor Coach Advertising Service, Inc	10.00	10.00
Parker, Griesar & Savel, Inc	10.00	56.25
Pacific Railways Advertising Company	10.00	10.00
Manhattan General Equipment Co	500.00	500.00
The Tabard Press	4,220.87	4,204.26
Luna Amusement Company	3,408.53	4,196.03
Crazy Village Amusement Corporation	100.67	10.00
American Ammone Company	1,680.12	1,680.53

5. The facts upon which the petitioner relies as a basis of this proceeding are as follows:

(a) The petitioner during the years 1925 and 1926 was one of a group of corporations, affiliated within the meaning of the provisions of Section 240 of the Revenue Act of 1926 with the corporations hereinafter listed, the gross income and deductions of which were reported in a consolidated return for each of said years, filed by United Brokerage Company, a Delaware corporation, as provided by said section.

Name

United Brokerage Company (Del.)
Street Railways Advertising Company (Del.)
The Stearn Advertising Company of New York

[fol. 10] Barron G. Collier Inc. (N. Y.)
Barron G. Collier, Incorporated, of Texas
Street Railways Advertising Company (N. Y.)
Broadway Subway Advertising Co., Inc.
Empire State Advertising Company
Middle States Publicity Company, Inc.
Mark D. Batchelder Company
Motor Coach Advertising Service, Inc. (Md.)
Motor Coach Advertising Service, Inc. (N. Y.)
Motor Coach Advertising Service, Inc. (Ill.)
A. H. Armstrong Company
Southern Advertising Agency, Inc.
East St. Louis Car Advertising Co., Inc.
Iroquois Advertising Company
Western Car Advertising Company
Transit Sales Corporation
Standard Vending Corporation
Advertising Samplers, Inc.

Interstate Sales Company
Bus Advertising Service, Inc. (Del.)
*Ridgways, Incorporated
De Soto Paint Manufacturing Company
Quincy Warehouse Company
Parker, Griesar & Savel, Inc.
The Florida Railroad and Navigation Corporation
Florida Gulf Coast Hotels, Inc.
Alexander, Ramsey & Kerr, Inc.
Island Realty Company
Deep Lake Company
[fol. 11] Automatic Machine Development Corporation
Advertisers Service Corporation
*Listerated Gum Corporation
**Artemas Ward, Inc. (Del.)
*Artemas Ward, Inc. (N. Y.)
Street Railways Advertising Company (N. J.
Western Advertising Company
Barron G. Collier, Incorporated, of Delaware
Chicago Elevated Advertising Company
Neighborhood Stores Display Service, Inc.
Inland Advertising Agency
Northwestern Advertising Company, Inc.
Universal Vending Service Company
Pacific Railways Advertising Company
The Stearn Advertising Company (Ohio)
Manhattan General Equipment Co.
The Tabard Press
Luna Amusement Company
Crazy Village Amusement Corporation
Witching Waves Company
Helter Skelter Slide Corporation
Harum Scarum Amusement Corporation
Oceanview Realty Operating Company, Inc.
Lee County Land Company
Gulf Coast Realties Corporation
Florida Timber Lands Corporation

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* Included in the consolidated return of the year 1925 only.

** Included in the consolidated return of the year 1926 only.

Manhattan Mercantile Corporation
The Barfield Company
Island Investment Company
[fol. 12] Florida Development Company
Philadelphia Advertising Company
John Weiss, Inc., Photographers
Inter County Telephone & Telegraph Company
Everglades Publishing Company
American Ammone Company
Times Square Utilities Company, Inc.
United Stores Land & Improvement Company
**Caloosahatchee Tropical Company

(b) The respondent has determined that the corporations listed in paragraph 5 (a) above were affiliated within the meaning of the Revenue Act of 1926 for the years 1925 and/or 1926 and were permitted to file consolidated returns of net income for such years, and has determined the tax liability of the consolidated group upon the basis of consolidated returns and has determined the proportion of such tax which should be assessed upon the petitioner for such years.

(c) From the date of the opening of the first subway in the City of New York in 1903 and for some time subsequent to March 1, 1913, the advertising, vending and news selling privileges within the cars and stations of the subways and elevated railways of the Interborough Rapid Transit Company and affiliated companies were owned or controlled [fol. 13] by Artemas Ward and William Gow as equal partners in the firm of Ward & Gow, or by Artemas Ward, individually, doing business under the style and name of Ward & Gow. Prior to March 1, 1913, the said Artemas Ward acquired the interest of said William Gow in the partnership of Ward & Gow. In the acquisition of this one-half interest, the said Artemas Ward paid said Gow the sum of $1,665,910.92 for Gow's interest in said contract with the Interborough Rapid Transit Company. The contract in existence on March 1, 1913, with the Interborough Rapid Transit was by its terms to continue in existence until December 31, 1918. Early in the year 1913 negotiations were entered into

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** Included in the consolidated return of the year 1926 only.

between said Artemas Ward and the Interborough Rapid Transit Company for the purpose of obtaining an extension or continuance of the privileges existing under the contract for a period of ten years, or to December 31, 1928. For and in consideration of the agreement on the part of said Artemas Ward to pay during the years 1914 to 1918, inclusive, the sum of $1,150,000 more than was called for under the terms of the contract in existence at March 1, 1913, as well as the agreement of said Artemas Ward to pay certain specified rentals for the period from January 1, 1919 to December 31, 1928, the Interborough Rapid Transit Company agreed by an instrument dated December 27, 1913, to an extension or continuance of the privileges and obligations of said contract to December 31, 1928.

[fol. 14] (d) The fair market value of said contract on March 1, 1913, was not less than $3,028,096.42. In the final determination of the Federal income tax liability of said Artemas Ward for the years 1913 to 1920, inclusive, the respondent has determined that said contract had a March 1, 1913, fair market value of $3,028,096.42 and has allowed deductions in the computation of the net income of said Artemas Ward for each of such years on account of the exhaustion of such contract based upon such value.

(e) On March 13, 1922, the assets of said Artemas Ward, used in the conduct of his advertising, vending and news selling business, including the said contract with the Interborough Rapid Transit Company, were transferred to Artemas Ward, Inc., a New York corporation, in exchange for the stock of said corporation.

(f) On June 30, 1925, the issued and outstanding capital stock of said Artemas Ward, Inc., was acquired by United Brokerage Company, a Delaware corporation, one of the group of corporations listed in paragraph 5 (a) above.

(g) The contract between said Artemas Ward, Inc., and the Interborough Rapid Transit Company was terminated November 1, 1925, by the Transit Commission of the State of New York.

(h) In the determination of the net income of said Artemas Ward, Inc., for the period from July 1, 1925 to [fol. 15] December 31, 1925, the respondent has failed to allow a deduction on account of the exhaustion of the March

1, 1913, fair market value or of the cost of said contract for the months of July, August, September and October prior to its cancellation on November 1, 1925. The respondent has also failed to allow a deduction on account of the loss sustained by said Artemas Ward, Inc., resulting from the cancellation of said contract on November 1, 1925, of not less than $605,619.30, the unexhausted portion of the March 1, 1913, fair market value or of the cost thereof.

(i) As hereinbefore stated United Brokerage Company, a Delaware corporation, acquired the issued and outstanding capital stock of Artemas Ward, Inc., a New York corporation, on June 30, 1925. The cost of this stock was $3,414,345.63, representing the cash consideration agreed to be paid. On December 31, 1925, the net book value of the assets of said Artemas Ward, Inc., was the sum of $1,246,920.07. On December 31, 1925, pursuant to a plan of reorganization the said Artemas Ward, Inc., transferred all of its assets, subject to liabilities, with the exception of cash and accounts receivable aggregating $284,967.21, to Artemas Ward, Inc., a corporation organized under the laws of the State of Delaware, in exchange for 100 shares of the no par value common stock of that corporation. Immediately after this transfer and on December 31, 1925, Artemas Ward, Inc., a New York corporation, distributed [fol. 16] to its sole stockholder, United Brokerage Company, a Delaware corporation, the 100 shares of the capital stock of Artemas Ward, Inc., a Delaware corporation, and accounts receivable aggregating $234,967.21.

(j) On December 15, 1926, United Brokerage Company, a Delaware corporation, sold 497 shares of the no par common stock of Artemas Ward, Inc., a New York corporation, to George B. Anderson, an individual, for $4,970. Thereafter and on December 24, 1926, said United Brokerage Company sold to said Anderson for $44,670, all the remaining outstanding stock of Artemas Ward, Inc., a New York corporation, consisting of 4,467 shares. The resulting losses from these two transactions were, respectively, $306,601.60 and $2,755,712.94, a total of $3,062,314.54 and have not been allowed as deductions in computing the net income of said United Brokerage Company for the year 1926. The aggregate amount allowed by the respondent on account of these losses is $495,696.76.

(k) During the years 1923 and/or 1924 the corporations hereinafter listed in this paragraph, which have been determined by the respondent to have been affiliated with the petitioner for the year 1925, sustained net losses in respect of which the respondent has failed and refused to allow deductions for the year 1925 in computing the net income of such corporations, the consolidated net income, the total tax of the consolidated group, and the proportion [fol. 17] of such tax to be assessed upon the petitioner. The amount of the net loss of each such corporation for each year is that set opposite the name of the respective corporations.

Name	Year 1923	Year 1924
United Brokerage Company (Del.)	$ ——	$207,799.89
Street Railways Advertising Company (Del.)	——	11,577.84
Street Railways Advertising Company (N. Y.)	55,190.96	27,660.81
Broadway Subway Advertising Co., Inc		175,003.34
Mark D. Batchelder Company	5,495.80	——
*(Motor Coach Advertising Service, Inc. (Md.)		11,934.84
(Bus Advertising Service, Inc. (Md.)	13,220.83	
*(Motor Coach Advertising Service, Inc. (N. Y.)		
(Bus Advertising Service, Inc. (N. Y.)	7,102.65	7,193.09
A. H. Armstrong Company	——	867.42
Iroquois Advertising Company	1,521.96	——
Transit Sales Corporation	13,405.53	3,146.12
Standard Vending Corporation	5,881.28	8,849.95
*(Advertising Samplers, Inc		
(National Vending Service, Inc	26,149.75	17,342.84
Interstate Sales Company	5,508.19	2,721.13
De Soto Paint Manufacturing Company	33,199.51	2,223.22
Quincy Warehouse Company	16,254.12	9,324.34
*(The Florida Railroad and Navigation Corporation.	58,800.58	304,425.11
(Florida Hotel and Navigation Company		
Florida Gulf Coast Hotels, Inc	32,126.03	42,396.78
Alexander, Ramsey & Kerr, Inc	——	2,029.79
*(Island Realty Company		2,755.56
(Island Investment Company	650.33	
Deep Lake Company	216,553.75	38,469.57
*(Neighborhood Stores Display Service, Inc		
(Manufacturers Display Service Corp	10,429.84	6,843.29
[fol. 18]		
Universal Vending Service Company	53,711.58	43,392.89
Luna Amusement Company	263,118.48	——
Crazy Village Amusement Corporation	5,894.32	——
Harum Scarum Amusement Corporation	17,406.03	——
Lee County Land Company	1,710.37	7,117.19
Gulf Coast Realties Corporation	207.81	——
Florida Timber Lands Corporation	687.32	4,321.32
The Barfield Company	2,489.84	——
Florida Development Company		26,117.20
Inter County Telephone & Telegraph Company		7,615.04

* Change of name.

(l) All corporations of the affiliated group listed in paragraph (k) above which had losses and net losses for the

year 1923 also had losses and net losses for the year 1924 except those listed hereunder in this paragraph, which had net income (computed without deduction for net losses of the year 1923) in the amounts set opposite the names of the respective corporations.

Name	1924 Net Income Computed Without Deduction for 1923 Net Loss
Mark D. Batchelder Company	$276.76
Iroquois Advertising Company	795.57
Luna Amusement Company	75,745.14
Crazy Village Amusement Corporation	2,236.80
Harum Scarum Amusement Corporation	8,183.93
Gulf Coast Realties Corporation	17.56
The Barfield Company	601.64

(m) During the years 1924 and/or 1925 the corporations [fol. 19] hereinafter listed in this paragraph, which have been determined by the respondent to have been affiliated with the petitioner for the year 1926, sustained net losses in respect of which the respondent has failed and refused to allow deductions for the year 1926 in computing the net income of such corporations, the consolidated net income, the total tax of the consolidated group, and the proportion of such tax to be assessed upon the petitioner. The amount of the net loss of each such corporation for each year is that set opposite the name of the respective corporations.

Name	Year 1924	Year 1925
United Brokerage Company (Del.)	$207,799.89	$237,982.09
Street Railways Advertising Company (N. Y.)	27,660.81	14,925.62
Broadway Subway Advertising Co., Inc	175,003.34	—
Mark D. Batchelder Company	—	1,294.66
Motor Coach Advertising Service, Inc. (Md.)	11,934.84	37,752.08
(Motor Coach Advertising Service, Inc. (N. Y.)		12.15
*(Bus Advertising Service, Inc. (Md.)	7,193.09	
A. H. Armstrong Company	867.42	1,415.64
Iroquois Advertising Company	—	1,294.30
Transit Sales Corporation	3,146.12	2,405.25
Standard Vending Corporation	8,849.95	8,369.19
*(Advertising Samplers, Inc		25,195.03
(National Vending Service, Inc	17,342.84	
Interstate Sales Company	2,721.13	1,922.11
Bus Advertising Service, Inc. (Del.)	—	280.83
Quincy Warehouse Company	9,324.34	3,499.48
The Florida Railroad and Navigation Corporation	304,425.11	278,038.98

* Change of name.

]fo.l 20] Name	Year 1923	Year 1924
Florida Gulf Coast Hotels, Inc	42,396.78	54,536.64
Island Realty Company	2,755.56	570.29
Deep Lake Company	38,469.57	21,397.04
Advertisers Service Corporation	——	32.87
*(Neighborhood Stores Display Service, Inc		6,330.38
(Manufacturers Display Service Corp	6,843.29	
Northwestern Advertising Company, Inc	——	31,783.35
Universal Vending Service Company	43,392.89	38,216.45
Crazy Village Amusement Corporation	——	7,580.15
Witching Waves Company	——	4,151.49
Harum Scarum Amusement Corporation	——	1,012.96
Lee County Land Company	7,117.19	74,069.56
Gulf Coast Realties Corporation	——	20,932.37
Florida Timber Lands Corporation	4,321.32	78,417.58
The Barfield Company	——	8,864.38
Florida Development Company	26,117.20	21,031.34
John Weiss, Inc., Photographers	——	118.31
Inter County Telephone & Telegraph Company	7,615.04	23,824.79
Everglades Publishing Company	——	2,433.34
Times Square Utilities Company, Inc	——	1,838.57

(n) All corporations of the affiliated group listed in paragraph (m) above which had losses and net losses for the year 1924 also had losses and net losses for the year 1925 except Broadway Subway Advertising Company which in the year 1925 had net income (computed without deduction for net loss of the year 1924) of $138,451.18.

(o) During the years 1925 and 1926 the corporations [fol. 21] hereinafter listed in this paragraph became liable under the statutes of the State of New York for franchise taxes which have been assessed in the amounts set opposite their respective names and which the respondent has failed to allow as deductions in computing the net income of such corporations, as well as the consolidated net income, the total tax of the consolidated group, and the proportion of such tax to be assessed upon the petitioner.

Name	Year 1925	Year 1926
Barron G. Collier, Inc. (N. Y.)	$47,332.38	$2,803.22
Street Railways Advertising Company (N. Y.)	15.00	15.00
Empire State Advertising Company	155.93	25.00
Motor Coach Advertising Service, Inc	10.00	10.00
Parker, Griesar & Savel, Inc	10.00	56.25
Pacific Railways Advertising Company	10.00	10.00
Manhattan General Equipment Co	500.00	500.00
The Tabard Press	4,220.87	4,204.26
Luna Amusement Company	3,408.53	4,196.03
Crazy Village Amusement Corporation	100.67	10.00
American Ammone Company	1,680.12	1,680.53

Wherefore, the petitioner prays that the Board may hear this proceeding and find and determine as follows:

(a) That Artemas Ward, Inc., a New York corporation, is entitled to a deduction in computing net income for the

year 1925 for the exhaustion of the March 1, 1913, fair market value or of the cost of a contract with the Interborough Rapid Transit Company, of not less than $63,749.40.

(b) That Artemas Ward, Inc., a New York corporation, [fol. 22] is entitled to a deduction in computing net income for the year 1925, for a loss sustained by reason of the cancellation of the contract with the Interborough Rapid Transit Company on November 1, 1925, of not less than $605,619.30.

(c) That United Brokerage Company, a Delaware corporation, is entitled to deductions in computing net income for the year 1926, for losses sustained on sales of the capital stock of Artemas Ward, Inc., a New York corporation, in the aggregate amount of $3,062,314.54 instead of the aggregate amount of $495,696.76, allowed by the respondent.

(d) That in computing net income for the year 1925 of the corporations listed in paragraph 5 (k), deductions be allowed on account of the net losses of such corporations for the years 1923 and/or 1924 as required by the provisions of Section 206 of the Revenue Act of 1926.

(e) That in computing net income for the year 1926 of the corporations listed in paragraph 5 (m), deductions be allowed on account of the net losses of such corporations for the years 1924 and/or 1925 as required by the provisions of Section 206 of the Revenue Act of 1926.

(f) That in computing net income for the years 1925 and 1926 of the corporations listed in paragraph 5 (o), deductions be allowed for New York State franchise taxes accrued during such years in the amounts shown in said paragraph 5 (o).

[fol. 23] (g) Such other and further relief to which the petitioner may be entitled under the Revenue Act of 1926.

(Sgd.) Laurence Graves, Murphy, Lanier and Quinn, 618 Southern Building, Washington, D. C. Of Counsel: G. A. O'Donoghue, Murphy, Lanier and Quinn, 522 Fifth Avenue, New York, N. Y. A. M. Kracke, Davis & Kracke, The Rookery, Chicago, Ill., Attorneys for Petitioner.

Duly sworn to by J. O. Pau. Jurat omitted in printing.

[fol. 24] EXHIBIT "A" TO PETITION

Copy

NP-2-26.

Treasury Department, Washington

Office of Commissioner of Internal Revenue

Address reply to Commissioner of Internal Revenue and refer to Manhattan General Equipment Company, c/o United Brokerage Company of Delaware, 220 West 42nd Street, New York, New York.

SIRS: Oct. 21, 1930.

You are advised that the determination of your tax liability for the years 1925 and 1926 discloses a deficiency of $898.59, as shown in the statement attached.

In accordance with Section 274 of the Revenue Act of 1926, notice is hereby given of the deficiency mentioned. Within sixty days (not counting Sunday as the sixtieth day) from the date of the mailing of this letter, you may petition the United States Board of Tax Appeals for a redetermination of your tax liability.

However, if you do not desire to petition, you are requested to execute the enclosed agreement form and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P-7. The signing of this agreement will expedite the closing of your returns [fol. 25] by permitting an early assessment of any deficiency and preventing the accumulation of interest charges, since the interest period terminates thirty days after filing the enclosed agreement, or on the date assessment is made, whichever is earlier; whereas if no agreement is filed, interest will accumulate to the date of assessment of the deficiency.

Respectfully, David Burnet, Commissioner, by J. C. Wilmer, Deputy Commissioner.

Enclosures: Statement, Form 882, Form 870.

IT:AR:A-5.
HGF-60D.

Statement of Returns Examined

and

Resulting Tax Liability

Returns Examined

Company.	Year.	Form.
Manhattan General Equipment Company, c/o United Brokerage Company of Delaware, 220 West 42nd Street, New York, New York.	1925	*
	1926	*

[fol. 26]

Tax Liability

Year.	Corrected tax liability.	Tax previously assessed.	Deficiency.
1925	$564.80	None	$564.80
1926	333.79	None	333.79
Totals	$898.59	None	$898.59

Allocation of this tax to your company is in accordance with the provisions of Section 240 of the Revenue Act of 1926, and is fully explained in a separate communication addressed to the United Brokerage Company of Delaware.

Consents which will expire December 31, 1930, except as extended by the provisions of Section 277(b) of the Revenue Act of 1926, are on file for the years 1925 and 1926.

BEFORE UNITED STATES BOARD OF TAX APPEALS

[Title omitted]

ANSWER—Filed Feb. 10, 1931

The Commissioner of Internal Revenue, by his attorney, C. M. Charest, General Counsel, Bureau of Internal Reve-

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* The income has been reported in the consolidated returns filed by the United Brokerage Company of Delaware, Parent.

nue, for answer to the petition filed in the above-entitled appeal, admits and denies as follows:

[fol. 27] 1, 2 and 3. Admits the allegations in paragraphs 1, 2 and 3.

4. Denies the notice of deficiency is based upon the errors alleged and set forth in paragraphs 4(a to f).

5(a). Admits the allegations contained in paragraph 5(a), except that it is denied that the petitioner was held by the respondent to be affiliated with Ridgways, Incorporated.

5(b). Admits the allegations contained in paragraph 5(b), except that it is denied that Ridgways, Incorporated, was affiliated with the consolidated group of which petitioner is a member.

5(c). Denies the allegations contained in paragraph 5(c).

5(d) Admits the allegations contained in paragraph 5(d), except it is denied that the March 1, 1913, value of the contract in question was $3,028,096.42.

5(e) Admits the allegations in paragraph 5(e).

5(f) and 5(g). Denies the allegations in paragraphs 5(f) and 5(g).

5(h). Admits the allegations in paragraph 5(h).

5(i) to 5(o). Denies the allegations in paragraphs 5(i) to 5(o) inclusive.

Wherefore, it is prayed that the taxpayer's appeal be denied.

(Signed) C. M. Charest, General Counsel, Bureau of Internal Revenue. Of Counsel: W. Frank Gibbs, Special Attorney, Bureau of Internal Revenue.

[fol. 28] BEFORE UNITED STATES BOARD OF TAX APPEALS

[Title omitted]

AMENDMENT TO PETITION

(Excerpt from Transcript of Hearing of Jan. 16, 1933)

Mr. Graves: With respect to the amount of tax—the amount of deduction on the loss of the contract, it seems to me that is purely a matter of argument. We have claimed $604,000. I hate to amend all of these 35 petitions to make my claim for the larger amount——

Mr. Gibbs: That brings up a question—I have no objection to the procedure, which I think is practiced in presenting cases to the Board, that the pleadings may be considered to conform to the proof which we are now submitting, and if that is agreeable, I have no objection to that procedure.

The Member: If we reach a conclusion that a higher value than $605,000 should be allowed, we can consider that the petitions ask for the higher value?

Mr. Gibbs: Yes.

The Member: Very well.

[fol. 29] BEFORE UNITED STATES BOARD OF TAX APPEALS

[Title omitted]

STIPULATION OF FACTS—Filed Jan. 16, 1933

It is hereby agreed and stipulated by and between the parties to this proceeding through their respective attorneys that the following facts are true, without prejudice to the rights of either party to present further or additional evidence:

1. The petitioner is one of a group of thirty-four affiliated corporations having appeals pending before this Board involving the taxable years 1925 and/or 1926. The names of

such corporations and the docket numbers of their respective appeals are as follows:

Name.	Docket No.
Southern Advertising Agency, Inc.	51346
Neighborhood Stores Display Service, Inc.	51347
Artemas Ward, Inc.	51348
Luna Amusement Company	51349
Harum Scarum Amusement Corporation	51350
The Stearn Advertising Company	51351
[fol. 30] Motor Coach Advertising Service, Inc.	51352
Philadelphia Advertising Company	51353
Bluff City Paint Company (formerly DeSoto Paint Manufacturing Company)	51354
Parker, Griesar & Savel, Inc.	51355
Inland Advertising Agency	51356
Western Advertising Company	51357
Collier Advertising Service, Inc. (formerly Artemas Ward, Inc.)	51358
Barron G. Collier, Incorporated, of Texas	51359
Iroquois Advertising Company	51360
Helter Skelter Slide Corporation	51361
Chicago Elevated Advertising Company	51363
The Tabard Press	51364
Empire State Advertising Company	51365
Oceanview Realty Operating Company, Inc.	51366
The Stearn Advertising Company of New York	51367
Barron G. Collier, Inc.	51368
A. H. Armstrong Company	51369
Mark D. Batchelder Company	51370
Collier Service Corporation (formerly Broadway Subway Advertising Co., Inc.)	51372
Alexander, Ramsey & Kerr, Inc.	51373
Middle States Publicity Company, Inc.	51374
American Ammone Company	51375
Pacific Railways Advertising Company	51376
Street Railways Advertising Company	51377
Manhattan Mercantile Corporation	51378
United Stores Land & Improvement Company	51379
Island Investment Company	51380

2. This stipulation of facts shall serve as a stipulation of [fol. 31] the facts in each of the proceedings listed in the

preceding paragraph, which have been or will be consolidated for hearing and decision with this proceeding.

3. The petitioner during the years 1925 and 1926 was one of a group of corporations affiliated, within the meaning of the provisions of Section 240 of the Revenue Act of 1926, with the following corporations, the gross income and deductions of which were reported in a consolidated return for each of said years, filed by United Brokerage Company, a Delaware corporation, as provided in said section:

United Brokerage Company (Del.).
Street Railways Advertising Company (Del.).
The Stearn Advertising Company of New York.
Barron G. Collier, Inc. (N. Y.).
Barron G. Collier, Incorporated, of Texas.
Street Railways Advertising Company (N. Y.).
Broadway Subway Advertising Co., Inc.
Empire State Advertising Company.
Middle States Publicity Company, Inc.
Mark D. Batchelder Company.
Motor Coach Advertising Service, Inc. (Md.).
Motor Coach Advertising Service, Inc. (N. Y.).
Motor Coach Advertising Service, Inc. (Ill.).
A. H. Armstrong Company.
Southern Advertising Agency, Inc.
East St. Louis Car Advertising Co., Inc.
Iroquois Advertising Company.
Western Car Advertising Company.
Transit Sales Corporation.
[fol. 32] Standard Vending Corporation.
Advertising Samplers, Inc.
Interstate Sales Company.
Bus Advertising Service Inc. (Del.).
De Soto Paint Manufacturing Company.
Quincy Warehouse Company.
Parker, Griesar & Savel, Inc.
The Florida Railroad and Navigation Corporation.
Florida Gulf Coast Hotels, Inc.
Alexander, Ramsey & Kerr, Inc.
Island Realty Company.
Deep Lake Company.
Automatic Machine Development Corporation.
Advertisers Service Corporation.

* Listerated Gum Corporation.
** Artemas Ward, Inc. (Del.).
* Artemas Ward, Inc. (N. Y.).
Street Railways Advertising Company (N. J.)
Western Advertising Company.
Barron G. Collier, Incorporated, of Delaware.
Chicago Elevated Advertising Company.
Neighborhood Stores Display Service, Inc.
Inland Advertising Agency.
Northwestern Advertising Company, Inc.
Universal Vending Service Company.
Pacific Railways Advertising Company.
The Stearn Advertising Company (Ohio).
Manhattan General Equipment Co.
The Tabard Press.
Luna Amusement Company.
[fol. 33] Crazy Village Amusement Corporation.
Witching Waves Company.
Helter Skelter Slide Corporation.
Harum Scarum Amusement Corporation.
Oceanview Realty Operating Company, Inc.
Lee County Land Company.
Gulf Coast Realties Corporation.
Florida Timber Lands Corporation.
Manhattan Mercantile Corporation.
The Barfield Company.
Island Investment Company.
Florida Development Company.
Philadelphia Advertising Company.
John Weiss, Inc., Photographers.
Inter County Telephone & Telegraph Company.
Everglades Publishing Company.
American Ammone Company.
Times Square Utilities Company, Inc.
United Stores Land & Improvement Company.
**Caloosahatchee Tropical Company.

4. The respondent has determined that the corporations listed in the preceding paragraph were affiliated within the meaning of the Revenue Act of 1926 for the years 1925

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* Included in the consolidated return of the year 1925 only.
** Included in the consolidated return of the year 1926 only.

and/or 1926 and were permitted to file consolidated returns of net income for such years and has determined the tax liability of such corporations upon the basis of the consolidated returns filed by said United brokerage Company for such corporations for such years and has determined the proportion of the tax found to be due upon such returns which should be assessed upon each of such corporations.

[fol. 34] 5. Artemas Ward, Inc, Inc. (N. Y.), which was affiliated with the petitioner from July 1, 1925 to December 31, 1925, was organized as a corporation under the laws of the State of New York on or about December 30, 1921 and on March 13, 1922, acquired the assets employed by one Artemas Ward in his advertising vending and news selling business, in exchange for the issuance of its entire stock to said Artemas Ward. One of the assets so acquired was a contract with Interborough Rapid Transit Company, a corporation engaged in business in New York City, which granted to said Artemas Ward the advertising, vending and news selling privileges in the cars and stations of the subways and elevated railways of Interborough Rapid Transit Company and affiliated companies. This contract by its terms was to continue until December 31, 1928.

6. The fair market value of said contract on March 1, 1913, was $3,028,096.42. In the determination of the Federal income tax liability of said Artemas Ward for the years 1913 to 1920, inclusive, the respondent has allowed as deductions in computing net income the following amounts on account of the exhaustion of said March 1, 1913, value of said contract:

1913	$159,373.50
1914	191,248.20
1915	191,248.20
1916	191,248.20
1917	191,248.20
1918	191,248.20
1919	191,248.20
1920	191,248.20

[fol. 35] 7. The gross income and deductions from the advertising, vending and news selling business of said Artemas Ward for the year 1921 and for the period January 1, 1922 to March 13, 1922, were reported in Federal income

tax returns filed by said Artemas Ward, Inc., under the provisions of Section 229 of the Revenue Act of 1921. In the determination of the Federal income tax liability of said Artemas Ward, Inc., for the years 1921, 1922, 1923, 1924 and for the period January 1, 1925 to June 30, 1925, the respondent has allowed the following deductions in computing net income on account of the exhaustion of the value of said contract with Interborough Rapid Transit Company:

1921	$191,248.20
1922	766,642.59
1123	766,642.59
1924	191,248.20
Jan. 1 to June 30, 1925	95,624.10

8. The deduction allowable in the computation of the net income of said Artemas Ward, Inc., for the period January 1, 1922 to March 13, 1922, on account of the exhaustion of the March 1, 1913 value of said contract with Interborough Rapid Transit Company is $37,201.66. The deduction allowable in the computation of the net income of said Artemas Ward, Inc., for the period from March 14, 1922 to December 31, 1922, is the amount of $613,314.07, based upon a value for said contract at the time it was acquired by said Artemas Ward, Inc., in excess of the March 1, 1913 value thereof.

[fol. 36] 9. On June 30, 1925, the issued and outstanding capital stock of said Artemas Ward, Inc., consisting of 4,964 shares of no par value common stock, was acquired by said United Brokerage Company at a cost of $3,414,345.63.

10. The said contract with Interborough Rapid Transit Company was terminated November 1, 1925, by the Transit Commission of the State of New York.

11. In the determination of the net income of said Artemas Ward, Inc., for the period from July 1, 1925 to December 31, 1925, the respondent has failed to allow a deduction on account of the exhaustion of the March 1, 1913, fair market value of said contract with Interborough Rapid Transit Company for the months of July, August, September and October, prior to its cancellation on November 1, 1925. The deduction allowable for the exhaustion of said value for said months is $63,749.40.

12. In the consolidated return filed by said United Brokerage Company for the calendar year 1925 the gross income and deductions of said Artemas Ward, Inc., were reported for the period July 1 to december 31, 1925. A deduction of $2,427,701.18 was claimed in said return by said Artemas Ward, Inc., as the amount of the loss sustained by it as the result of the cancellation of said contract with Interborough Rapid Transit Company on November 1, 1925.

13. In the determination of net income of said Artemas Ward, Inc., for the period from July 1, 1925 to December [fol. 37] 31, 1925, the respondent has determined that said Artemas Ward, Inc., sustained no deductible loss by reason of the termination of said contract with Interborough Rapid Transit Company.

14. On December 31, 1925, the fair value of the net assets of said Artemas Ward, Inc., was $1,246,920.07. On December 31, 1925, in pursuance of a plan of reorganization, said Artemas Ward, Inc., transferred all of its assets subject to liabilities with the exception of cash and accounts receivable, aggregating $284,967.21, to Artemas Ward, Inc., a corporation organized under the laws of the State of Delaware, in exchange for the issuance to it of 100 shares of the no par value common stock of that corporation, said 100 shares being all of the issued and outstanding capital stock at said time. Immediately after this transfer and on December 31, 1925, Artemas Ward, Inc., a New York corporation, distributed to its sole stockholder, said United Brokerage Company, in pursuance of said plan, said 100 shares of the capital stock of Artemas Ward, Inc., a Delaware corporation, and accounts receivable aggregating $234,967.21, without the surrender by said United Brokerage Company of any of the capital stock of said Artemas Ward, Inc., a New York corporation.

15. On December 15, 1926, said United Brokerage Company sold 497 shares of the no par value common stock of Artemas Ward, Inc., a New York corporation, for $4,970.00 to George B. Anderson, who had no connection with any of the corporations a party to these proceedings either as an officer, employee or stockholder. Thereafter and on [fol. 38] December 24, 1926, said United Brokerage Company sold to said George B. Anderson all of the remaining

outstanding capital stock of said Artemas Ward, Inc., a New York corporation, consisting of 4,467 shares for $44,670.00.

16. In the consolidated return filed by said United Brokerage Company for itself and affiliated companies for the year 1925 a deduction of $3,062,314.54 was claimed by said United Brokerage Company as a loss resulting from said sales of the stock of Artemas Ward, Inc., a New York corporation, in December, 1926. The loss so claimed was computed in the following manner: The cost to said United Brokerage Company of the stock of Artemas Ward, Inc. a New York corporation, of $3,414,345.63 was apportioned between the 4,964 shares of the stock of said Artemas Ward Inc., a New York corporation, and the 100 shares of the stock of said Artemas Ward, Inc., a Delaware corporation, in accordance with the provisions of Article 1599 of Regulations 69 in force and effect at the time of said transactions in December, 1926. In accordance with the apportionment so made, the portion of said cost allocated to said 100 shares of stock of Artemas Ward, Inc., a Delaware corporation was $67,423.88 and the balance of said cost, namely, $3,346,921.75, was allocated to the 4,964 shares of the stock of Artemas Ward, Inc., a New York corporation.

17. The $3,346,921.75 so apportioned to the 4,964 shares of Artemas Ward, Inc., a New York corporation, was then reduced by $234,967.21, representing the value of the ac- [fol. 39] counts receivable distributed to said United Brokerage Company on December 31, 1925, by Artemas Ward, Inc., a New York corporation, as hereinbefore stated. The cost so apportioned to the 4,964 shares of stock of Artemas Ward, Inc., a New York corporation, was $3,111,954.54, to wit, $826,904621 per share, and when the 497 shares of said stock were sold on December 15, 1926, for $4,970.00 said United Brokerage Company computed its loss through said sale to be the sum of $306,601.60 and when the balance of said stock consisting of 4,467 shares was sold on December 24, 1926, said United Brokerage Company computed its loss through said sale to be $2,755,712.94, the aggregate of such losses being the amount of the $3,062,314.54 which was claimed as a deduction as hereinbefore stated.

18. In the determination of the deficiencies in tax for the year 1926 at issue in these proceedings the respondent has allowed as a deduction on account of the losses sustained by United Brokerage Company upon the sales of said stock of Artemas Ward, Inc., a New York corporation, in December, 1926, the amount of $495,696.76. Said amount was computed by the respondent in accordance with Treasury Decision 4274, promulgated November 12, 1929, amending Article 1599 of Regulations 69, in the following manner:

Cost of stock of Artemas Ward, Inc. (N. Y.)			$3,414,345.63
Net worth Artemas Ward, Inc. (N. Y.) Dec. 31, 1925 (date of reorganization)			$ 284,967.21
Net worth Artemas Ward, Inc. (Del.) Dec. 31, 1925			961,952.86
Total			$1,246,920.07

[fol. 40]

Ratio—			
To Artemas Ward, Inc. (N. Y.)			22.85369%
To Artemas Ward, Inc. (Del.)			77.14631%
Total			100.
Basis remaining after reorganization:			
Artemas Ward, Inc. (N. Y.) (3,414,345.63 x 22.85369%)			$ 780,303.97
Artemas Ward, Inc. (Del.) (3,414,345.63 x 77.14631%)			2,634,041.66
Total			$3,414,345.63
Basis Artemas Ward, Inc. (N. Y.)		$780,303.97	
Accounts Receivable and Cash	$284,967.21		
Cash Retained	50,000.00		
Distributed to United Brokerage Company of Delaware	$234,967.21	234,967.21	
Net basis		$545,336.76	
Selling prices—			
497 shares	$4,970.00		
4,467 shares	44,670.00		
		49,640.00	
Loss on sale		$495,696.76	

19. The corporations hereinafter listed in this paragraph are entitled to deductions for the years 1925 and 1926 on account of New York State franchise taxes, which have been assessed against them in the amounts set opposite their respective names, which amounts have not been allowed as deductions by the respondent in the determination of the deficiencies in tax at issue in these proceedings:

[fol. 41]

Name	Year 1925	Year 1926
Barron G. Collier, Inc. (N. Y.)	$47,332.38	$2,803.22
Street Railways Advertising Company (N. Y.)	15.00	15.00
Empire State Advertising Company	155.93	25.00
Motor Coach Advertising Service, Inc	10.00	10.00
Parker, Griesar & Savel, Inc	10.00	56.25
Pacific Railways Advertising Company	10.00	10.00
Manhattan General Equipment Co	500.00	500.00
The Tabard Press	4,220.87	4,204.26
Luna Amusement Company	3,408.53	4,196.03
Crazy Village Amusement Corporation	100.67	10.00
American Ammone Company	1,680.12	1,680.53

(S.) Laurence Graves, 618 Southern Building, Washington, D. C. (S.) Arthur M. Kracke, The Rookery, Chicago, Illinois, Attorneys for Petitioner. (S.) C. M. Charest, General Counsel, Bureau of Internal Revenue, Attorney for Respondent.

[fol. 42] BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket Nos. 51,345-51,361, 51,363-51,370, 51,372-51,380

MANHATTAN GENERAL EQUIPMENT COMPANY et al.[1],
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

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[1] Proceedings of the following petitioners are consolidated and decided herewith: Southern Advertising Agency, Inc.; Neighborhood Stores Display Service, Inc.; Artemas Ward, Inc., Luna Amusement Co.; Harum Scarum Amusement Corporation; The Stern Advertising Company; Motor Coach Advertising Service, Inc; Philadelphia Advertising Company; Bluff City Paint Company (formerly DeSota Paint Manufacturing Company); Parker Griesar & Savel Inc.; Inland Advertising Agency; Western Advertising Company; Collier Advertising Service, Inc. (formerly Artemas Ward, Inc.); Barron G. Collier, Inc., of Texas; Iroquois Advertising Co.; Helter Skelter Slide Corporation; Chicago Elevated Advertising Company; The Tabard Press; Empire State Advertising Company; Oceanview Realty Operating Company, Inc.; The Stern Advertising Company of New York; Barron G. Collier, Inc.; A. H. Armstrong Company;

Promulgated November 23, 1933

1. A corporation acquired a contract from an individual in an exchange upon which no gain or loss was recognized under the Revenue Act of 1921, and, under the Revenue Act of 1926, the basis for determining gain or loss to the corporation was the same as it would be in the hands of [fol. 43] the transferor. Held, in determining gain or loss resulting from cancellation of the contract prior to the end of its term, the basis should be reduced, not only by the deductions for exhaustion of the contract allowable to the corporation, but also by those allowable to the transferor.

2. Where a stockholder receives shares of stock in another corporation, pursuant to a plan of reorganization, without surrender of its original shares, and thereafter sells the original shares, the gain or loss on the shares sold should be computed by allocating the basis of the shares originally held between those shares and the shares acquired in the reorganization, in proportion to the value of each stock at the date of reorganization, rather than in proportion to the number of shares of each stock held at that time. Bertha G. Bamberger, 27 B. T. A. 785, followed.

Laurence Graves, Esq., and A. M. Kracke, Esq., for the Petitioners.

W. Frank Gibbs, Esq., for the Respondent.

OPINION

MURDOCK:

The taxes in controversy are income taxes for the years 1925 and 1926. The proceedings have been consolidated. The parties filed a stipulation of facts in which the affiliated status of the various petitioners and other pertinent facts are shown. There was no testimony or other evidence except a copy of a notice of deficiency.

Mark D. Batchelder Company; Collier Service Corporation (formerly Broadway Subway Advertising Co., Inc.); Alexander, Ramsey & Kerr, Inc.; Middle States Publicity Company, Inc.; American Ammone Company; Pacific Railways Advertising Company; Street Railways Advertising Company; Manhattan Mercantile Corporation; United Stores Land & Improvement Company; Island Investment Company.

[fol. 44] The only issue in so far as the year 1925 is concerned, is whether or not the basis for gain or loss to Artemass Ward, Inc., a corporation of New York, upon the cancellation of a certain contract, should be reduced by deductions for depreciation or exhaustion of the contract allowable to Artemas Ward, an individual, during the period of his ownership of the contract. The contract in question was between the Interborough Rapid Transit Co., a corporation engaged in business in New York City, and Artemas Ward, an individual whereby the former granted to the latter exclusive advertising, vending, and news-selling privileges in the cars and stations of the Transit Co. and its affiliated companies. The contract provided that it should continue until December 31, 1928. It was acquired by Artemas Ward prior to March 1, 1913, and the parties have stipulated that its fair market value on March 1, 1913, was $3,028,096.42.

Artemas Ward, Inc., one of the petitioners herein, was organized under the laws of the State of New York on or about December 30, 1921. On March 13, 1922, Artemas Ward transferred the contract in question to this corporation in exchange for all of its stock. The Transit Commission of the State of New York terminated the contract on November 1, 1925. The parties agree that the transaction whereby Artemas Ward transferred the contract to Artemas Ward, Inc., was one in which no gain or loss was recognized (section 202 [c] of the Revenue Act of 1921), and, therefore, the basis for gain or loss to the corporation on this contract, under the applicable provisions of the Revenue Act of 1926, is the same as the basis would be if [fol. 45] the contract had remained in the hands of Artemas Ward. See section 204 of the Revenue Act of 1926. They also agree that this basis is the fair market value of the contract on March 1, 1913, to wit, $3,028,096.42. Furthermore, there is no difference between the parties as to the amount of the deductions allowable under the various revenue acts to Artemas Ward, the individual, and to Artemas Ward, Inc.

The Commissioner has actually allowed deductions on account of the exhaustion of this contract in excess of the amount allowable. The petitioners concede that total deductions on account of the exhaustion of this contract, equal to the fair market value of the contract on March 1,

1913, have been properly allowed for periods prior to January 1, 1925. This rather unusual situation, where the entire basis has been deducted prior to the actual exhaustion of the contract, is explained by the fact that for a part of the year 1922, and for all of the year 1923, deductions were allowed to the corporation based upon the cost of the contract to the corporation, as provided by the Revenue Act of 1921. The corporation issued its stock for the contract. The value of the stock was the same as the value of the contract. At that time the contract was apparently much more valuable than it was on March 1, 1913, and for each of those two periods the deduction allowed and allowable far exceeded the annual deduction allowed for other years under the other revenue acts which provided that the basis for depreciation was the March 1, 1913, value.

The corporation claims that it sustained a deductible loss in 1925 on account of the termination of the contract, and [fol. 46] it now contends that this loss is measured by the difference between the March 1, 1913, value of the contract and $1,730,578.36, the deductions for exhaustion of the contract allowable to Artemas Ward, Inc. The Commissioner has allowed no loss. He contends that the basis of the March 1, 1913, value should be reduced, not only by the deductions for exhaustion of the contract allowance to Artemas Ward, Inc., but also by the deductions for exhaustion of the contract allowable to Artemas Ward, the individual. Thus reduced, the basis disappears and there is nothing left to be deducted as a loss. This is the sole difference between the parties which we are asked to consider for the year 1925.

Congress has permitted deductions to be taken for losses under certain circumstances. But one claiming such a deduction must have sustained a loss (Cf. United States v. Flannery, 268 U. S. 98), and must be able to point to some specific provision allowing the deduction. The Revenue Act of 1926, which is applicable to the calendar year 1925, provides in section 202 that the loss shall be the excess of the basis over the amount realized after the basis has been "diminished by the amount of the deductions for exhaustion, wear and tear, obsolescence, amortization, and depletion which have since the acquisition of the property been allowable in respect of such property under this Act or prior income tax laws * * *." Section 202 (b) (2). The contract in question was apparently canceled without

and recourse on the part of the corporation. The petitioners argue that the words "since the acquisition of the property" mean since the acquisition of the property by [fol. 47] the one claiming the loss. Thus they would not diminish the basis by the deductions for exhaustion which were allowable in respect of the property during the time that it was owned by Artemas Ward. The respondent contends that the diminution of the basis is not so limited. The case of Barnett Anchor Oil Co., 25 B. T. A. 746, relied upon by the petitioners, is not in point. There may be room for argument that this particular provision of the statute is not entirely clear, but we think that the intention of Congress is clear when the various provisions of the statute relating to this subject are considered together.

Normally, under the income tax acts gain or loss from an exchange of property for stock is recognized, the property in the hands of the new owner has a new basis for gain or loss, and deductions for exhaustion of the property are computed upon that same basis. The new basis is cost to the new owner. The present question would not arise were it not for exceptions to these general rules. Congress made an exception where an owner of property transferred it to a corporation for stock of that corporation and immediately after the transfer controlled the corporation. It said that under such circumstances no gain or loss to the transferor would be recognized. But it did not stop there. It made other special provisions so that neither the Government nor the taxpayers would be hurt as a result of the nonrecognition of gain or loss. These provisions in effect put the transferee in the transferor's place for tax purposes in so far as that particular property was concerned. Congress provided that the old basis for gain or loss on [fol. 48] the property should persist and apply to the property in the hands of the new owner. It also provided, in acts after the 1921 Act, that depreciation should be computed upon this same basis. The relationship between the old owner and the new was close and it was because of that fact that no gain or loss was recognized upon the transfer. The provisions protected both the Government and the taxpayers. The combination of transferor and transferee was to have neither greater nor less tax benefit from the exhaustion in use or from the disposition of the property than the return through tax free income of the transferor's basis.

If the petitioners' contention were correct, the Government would be the loser in every case through a duplication of deductions on the same asset. There would be no point in using the March 1, 1913, value as the basis for gain or loss and reducing it by less than the entire amount recovered through deductions for depreciation since March 1, 1913.

The Supreme Court of the United States has said that "the amount of the allowance for depreciation is the sum which would be set aside for the taxable year, in order that, at the end of the useful life of the plant in the business, the aggregate of sums set aside will (with the salvage value) suffice to provide an amount equal to the original cost." United States v. Ludey, 274 U. S. 295. The whole purpose of the deductions for depreciation and of the offset against the amount realized upon disposition of an asset, is to provide, from untaxed income, an amount equal to the basis. Where the basis has once been recovered through [fol. 49] such annual deductions, there is no portion of the basis left with which to offset the amount realized from the disposition of the property. If anything is recovered from the disposition of the property or from the use of the property over and above the basis, that amount is income. Likewise, where there has been a full recovery through annual deductions for exhaustion, there can be no loss thereafter if the property is taken away from the owner or its usefulness is otherwise terminated. The above statements are certainly true when applied to property continuously owned by the same taxpayer. Graves, Cox & Co., 27 B. T. A. 546; Elliott-Granite Linen Corp., 26 B. T. A. 936; Proximity Mfg. Co., 18 B. T. A. 691, 698, 699; Gardner Printing Co., 4 B. T. A. 37; Even Realty Co., 1 B. T. A. 355. In our opinion Congress intended to provide and did provide in the Revenue Act of 1926, where an asset is transferred by an individual to a corporation for the stock of the latter, and no gain or loss is recognized, that the two combined are entitled to offset against income the total basis of the transferor and no more. Any further allowance would result in a duplication of deductions for the same capital asset, and any less would not permit the taxpayer to recover the full basis tax free. The petitioners are not entitled to any deduction for 1925 representing loss upon the cancellation of this contract, for there was no loss based

upon March 1, 1913, value. Cf. United States v. Flannery, supra.

The only issue touching the year 1926 relates to the method of computation of gain to the United Brokerage Co. upon the sale by it of the capital stock of Artemas [fol. 50] Ward, Inc., a New York corporation. On June 30, 1925, the United Brokeraeg Co., of the affiliated group which is before us, acquired all of the outstanding capital stock of Artemas Ward, Inc., consisting of 4,964 shares of no par value common stock, at a cost of $3,414,345.63. On December 31, 1925, Artemas Ward, Inc., pursuant to a plan of reorganization, transferred all of its assets, except cash and accounts receivable aggregating $284,967.21, subject to all of its liabilities, to another corporation of the same name, organized under the laws of the State of Delaware, in exchange for all of the latter's stock, consisting of 100 shares of no par value common. The net value of the assets of the New York corporation on December 31, 1925, was $1,246,920.07. On the same day, but after the transfer, the New York corporation, pursuant to the plan of reorganization, distributed the 100 shares of stock in the Delaware corporation and accounts receivable aggregating $234,967.21 to its sole stockholder, the United Brokerage Co., without surrender by the latter of its stock in the New York corporation. After this transfer, the New York corporation had no liabilities and its only asset was $50,000 in cash. In December, 1926, the United Brokerage Co. sold all of the stock of Artemas Ward, Inc., the New York corporation, 4,964 shares, to an outside party for a total consideration of $49,640. The United Brokerage Co. filed a consolidated return for 1926 in which is claimed a deduction of $3,062,314.54 as a loss resulting from the sale of the stock of the New York corporation. In computing this loss it apportioned the original cost of the stock of the New York corporation between 4,964 shares of the stock [fol. 51] of the New York corporation and 100 shares of the stock of the Delaware corporation in proportion to the number of shares of each which it held. It thus allocated to the 100 shares of stock of the Delaware corporation $67,423.88 as a basis for gain or loss and it allocated to the 4,964 shares of the stock of the New York corporation $3,346,921.75 as a basis for gain or loss. It then reduced

the basis attributable to the shares of the New York corporation by $234,967.21, representing the value of accounts receivable of that corporation distributed to the United Brokerage Co. in December, 1925. The Commissioner, in determining the deficiencies for 1926, has allowed a loss of $495,696.76, which he computed in accordance with Treasury Decision 4274, which was promulgated on November 13, 1929, to amend article 1599 of Regulations 69, C. B. VIII-2, p. 240. The difference between his method of computation and that used by the taxpayer is that the respondent divided the original cost of the 4,964 shares of stock in the New York corporation between that stock and the stock of the Delaware corporation in proportion to the value of each stock at the date of reorganization and distribution, December 31, 1925. In this way he determined that the basis for gain or loss on the 4,964 shares of stock of the New York corporation was $780,303.97. He reduced this basis by $234,967.21, the value of the accounts receivable distributed to the United Brokerage Co., and then subtracted the total sale price of the shares, to wit, $49,640, which gave a loss on the sale of $495,696.76.

Although this case arises under an earlier revenue act and an earlier regulation is relied upon by the petitioners [fol. 52] than was the case in Bertha G. Bamberger, 27 B. T. A. 785, nevertheless the question here is the same as that decided by the Board in the Bamberger case. The petitioners apparently contend that the loss as computed on the consolidated return was in accordance with paragraph 1 of article 1599 of Regulations 69 as originally promulgated. It is to be regretted that such a regulation was published and allowed to stand for so many years, but, if the petitioner's contention is correct, the case demonstrates the unreasonableness of that regulation. All of the assets of the New York corporation were taken from it with the exception of $50,000 in cash, so that the 4,964 shares were backed by nothing more than $50,000 in cash. The 100 shares of Delaware corporation stock were backed by practically all of the remaining assets which had formerly belonged to the New York corporation. The net value of these assets was almost a million dollars, yet, under the petitioner's method, $3,111,954.54 of the original basis would be attributed to the New York stock and only $67,423.88 of the basis would be allocated to the Delaware

stock. Following our decision in the Bamberger case, we hold for the respondent on this point.

Decision will be entered under Rule 50.

(Seal.)

[fol. 53] BEFORE UNITED STATES BOARD OF TAX APPEALS.

Docket No. 51,345.

MANHATTAN GENERAL EQUIPMENT COMPANY, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

DECISION

Pursuant to the Board's opinion promulgated November 23, 1933, the parties on March 15, 1934, filed a stipulation of tax liability under Rule 50. Therefore, it is

Ordered and Decided that there are deficiencies for the years 1925 and 1926 in the amounts of $485.02 and $299.94, respectively.

(Signed) J. E. Murdock, Member, United States Board of Tax Appeals.

Enter:

Entered March 20, 1934.

(Seal.)

[fol. 54] BEFORE UNITED STATES BOARD OF TAX APPEALS

[Title omitted]

PETITION FOR REVIEW—Filed June 20, 1934

Comes now the petitioner, Manhattan General Equipment Company, by its attorneys, Laurence Graves and Arthur M. Kracke, and respectfully shows:

I

Jurisdiction

Your petitioner on review is a corporation organized under the laws of the State of New Jersey, with principal

place of business at 220 West 42nd Street, New York, New York. Your respondent on review is the duly appointed, qualified and acting Commissioner of Internal Revenue of the United States.

The petitioner's gross income and deductions for the years in question were included in consolidated returns for Federal income tax purposes filed by United Brokerage Company, a corporation, with the Collector of Internal Revenue for the Third District of New York, whose office [fol. 55] is located in the City of New York and within the judicial circuit of the United States Circuit Court of Appeals for the Second Circuit.

II

Previous Proceedings

The respondent determined that there were deficiencies in Federal income taxes for the calendar years 1925 and 1926, computed on the basis of the consolidated returns filed by United Brokerage Company and its affiliated corporations for those years. The respondent determined that the amounts of such deficiencies that should be apportioned to and assessed against the petitioner were $564.80 for the calendar year 1925 and $333.79 for the calendar year 1926 and, in accordance with the provisions of Section 274 of the Revenue Act of 1926, sent to the petitioner by registered mail a notice of said deficiencies. Thereafter the petitioner duly filed an appeal from said notice of deficiency with the United States Board of Tax Appeals, said appeal being assigned Docket No. 51,345.

Thereafter a hearing was held by said Board of Tax Appeals. On November 23, 1933, the Board of Tax Appeals promulgated its opinion and on March 20, 1934, said Board of Tax Appeals entered its final order and decision in said appeal, wherein and whereby the Board of Tax Appeals ordered and decided that there was a deficiency in tax for the calendar year 1925 of $485.02 and a deficiency for the calendar year 1926 of $299.94.

The opinion of the Board of Tax Appeals is published in 29 B. T. A. 395.

[fol. 56] III

Nature of Controversy

The nature of the controversy is as follows:

For the year 1925 the respondent determined that a loss claimed to have been sustained by Artemas Ward, Inc., a New York corporation, one of the corporations affiliated with the petitioner during that year, should be disallowed. The petitioner claimed that the amount of such loss was not less than $605,619.30. The effect of the disallowance of this loss was to increase the tax liability of the consolidated group and the amount of such liability to be apportioned to the petitioner.

For the year 1926 the respondent determined that a loss of $3,062,314.54 claimed by United Brokerage Company, one of the corporations affiliated with the petitioner for that year, should be allowed in the amount of $495,696.76 and the balance of the amount claimed disallowed. The effect of the disallowance of this loss was to increase the tax liability of the consolidated group and the amount of such liability to be apportioned to the petitioner.

Issue for 1925

During the calendar year 1925 the petitioner was affiliated with 66 corporations, the gross incomes and deductions of which were included in a consolidated return filed by the parent or principal corporation, United Brokerage Company, a Delaware corporation.

[fol. 57] The loss of not less than $605,619.30 claimed by Artemas Ward, Inc., a New York corporation, for the calendar year 1925 was one claimed to have been sustained by that corporation by reason of the cancellation on November 1, 1925, by the Transit Commission of the State of New York, of a contract with Interborough Rapid Transit Company.

Artemas Ward, Inc., was organized as a corporation under the laws of the State of New York prior to March 13, 1922, and acquired on that date the assets of one Artemas Ward, an individual, used by him in the conduct of an advertising, vending and news-selling business, including a contract with Interborough Rapid Transit Company for the advertising, vending and news-selling privileges within

the cars and stations of the subways and elevated railways of that company and affiliated companies. This contract had been acquired by said Artemas Ward prior to March 1, 1913, and the respondent stipulated that this contract had a fair market value on March 1, 1913, of $3,028,096.42. The contract with Interborough Rapid Transit Company so acquired by said Artemas Ward, Inc., would by its terms have expired on December 31, 1928.

In the determination of the Federal income tax liability of said Artemas Ward for the years 1913 to 1921, inclusive, the respondent allowed as deductions in computing net income on account of exhaustion of said fair market value $159,373.50 for 1913 and $191,248.20 for each of the other such years. In the determination of the Federal income tax liability of said Artemas Ward, Inc., for each of the years 1922 and 1923 the respondent allowed a deduction for [fol. 58] the exhaustion of such contract, upon the basis of an increased valuation, in the amount of $766,642.59. The respondent has allowed deductions to said Artemas Ward, Inc., for the exhaustion of said contract for the year 1924 in the amount of $191,248.20 and for the period January 1, 1925 to June 30, 1925, in the amount of $95,624.10. The parties have stipulated that the deduction allowable on account of the exhaustion of said contract for the period July 1, 1925 to October 31, 1925 was $63,749.40.

The loss of not less than $605,619.30 claimed by the petitioner in its petition was arrived at by subtracting from the March 1, 1913, value of $3,028,096.42 deductions for the annual exhaustion thereof since March 1, 1913 to November 1, 1925, at the rate of $191,248.20 per annum. On November 1, 1925, the portion of said March 1, 1913, value remaining after such deductions for exhaustion was $605,619.30.

The respondent in his determination reduced the March 1, 1913, value of said contract of $3,028,096.42 by the deductions allowed by him for the exhaustion of said contract since March 1, 1913, to Artemas Ward, the individual, in the amount of $1,689,359.10 as well as to said Artemas Ward, Inc., a New York corporation, in the amount of $1,883,906.88, and he found that the March 1, 1913, value had been entirely exhausted and, accordingly, disallowed the loss claimed to have been sustained.

It was contended by the petitioner at the hearing before the Board of Tax Appeals and in its brief to that Board

that said March 1, 1913, value of said contract of $3,028,-096.42 should be reduced only by the aggregate of the [fol. 59] deductions for exhaustion in respect thereof to which said Artemas Ward, Inc., was entitled after said contract was acquired by it, the aggregate of said deductions being $1,730,578.36, and that the loss sustained by reason of the cancellation of said contract on November 1, 1925, was the amount of $1,297,518.06. The Board of Tax Appeals approved the action of the respondent in disallowing the loss originally claimed and found that the petitioner had sustained no deductible loss by reason of the cancellation of said contract.

Issue for 1926

For the calendar year 1926 the petitioner was affiliated with 66 corporations, the gross incomes and deductions of which were included in a consolidated return filed by United Brokerage Company, a Delaware corporation.

On June 30, 1925, United Brokerage Company, a Delaware corporation, affiliated with the petitioner for both years in controversy, acquired the entire issued and outstanding capital stock of Artemas Ward, Inc., a New York corporation, consisting of 4,964 shares of no par value common stock, at a cost of $3,414,345.63. As hereinbefore stated, the principal asset of said Artemas Ward, Inc., was a certain contract with Interborough Rapid Transit Company, which was cancelled on November 1, 1925. On December 31, 1925, the net book value of the assets of said Artemas Ward, Inc., was the sum of $1,246,920.07. On December 31, 1925, pursuant to a plan of reorganization, said Artemas Ward, Inc., a New York corporation, transferred all of its assets subject to liabilities, with the ex- [fol. 60] ception of cash and accounts receivable aggregating $284,967.21, to Artemas Ward, Inc., a corporation organized under the laws of the State of Delaware, in exchange for the issuance to it of 100 shares of no par value common stock, representing all of the capital stock of that company issued and outstanding at that time. Immediately after this transfer and on December 31, 1925, said Artemas Ward, Inc., a New York corporation, distributed to its sole stockholder, said United Brokerage Company, in pursuance of said plan, said 100 shares of the capital stock of Artemas Ward, Inc., a Delaware corporation, and accounts receiv-

able aggregating $234,967.21, without the surrender by said United Brokerage Company of any of the capital stock of said Artemas Ward, Inc., a New York corporation.

On December 15, 1926, said United Brokerage Company sold 497 shares of the no par value common stock of Artemas Ward, Inc., a New York corporation, for $4,970.00. Thereafter and on December 24, 1926, said United Brokerage Company sold all of the remaining outstanding capital stock of said Artemas Ward, Inc., a New York corporation, consisting of 4,467 shares for $44,670.00.

In the consolidated return filed by said United Brokerage Company for itself and affiliated companies for the year 1926, a deduction of $3,062,314.54 was claimed by said United Brokerage Company as a loss resulting from said sales of stock of Artemas Ward, Inc., a New York corporation, in December, 1926. This loss was computed in accordance with the provisions of Paragraph (1) of Article 1599 of Regulations 69, in force and effect at the time of [fol. 61] said transactions in 1925 and 1926. This subdivision provided that the basis of each share of old and new stock would be the quotient of the basis of the old stock divided by the total number of old and new shares.

Thereafter and on November 13, 1929, the respondent revised said Article 1599 of Regulations 69 and provided that where the new stock was stock of a corporation other than the distributing corporation, the basis of the old stock should be apportioned between the old stock and the new stock in proportion to their respective values at the time of such distribution. Under the regulation as so amended he determined that the loss allowable on account of the sales of said stock of Artemas Ward, Inc., a New York corporation, was the amount of $495,696.76. In the proceedings before the Board of Tax Appeals it was contended by the petitioner that the loss sustained as a result of the sale of stock of Artemas Ward, Inc., a New York corporation, should be determined in accordance with the provisions of Article 1599 of Regulations 69 as originally promulgated. The Board of Tax Appeals held that the loss should be computed under the provisions of Article 1599 of Regulations 69 as revised on November 13, 1929, and sustained the action of the respondent in determining that the loss realized from the sale of said stock of Artemas Ward, Inc., a New York corporation, was $495,696.76.

IV

Assignments of Error

Petitioner believes and avers that errors were committed [fol. 62] by the Board of Tax Appeals to its damage and prejudice and assigns the following errors:

Errors Affecting the Year 1925

(1) The Board erred in holding that in determining the amount of loss sustained by Artemas Ward, Inc., a New York corporation, by reason of the cancellation of its contract with Interborough Rapid Transit Company, the basis of said contract, namely, the March 1, 1913, value of $3,028,096.42, should be reduced by deductions for exhaustion in excess of those which would have been allowable to Artemas Ward, an individual, if he had held said contract until the date of its cancellation, November 1, 1925.

(2) The Board erred in holding that in determining the amount of loss sustained by Artemas Ward, Inc., a New York corporation, by reason of the cancellation of its contract with Interborough Rapid Transit Company the basis of said contract, namely, the March 1, 1913, value of $3,028,096.42, should be reduced not only by the deductions for the exhaustion thereof allowed to said Artemas Ward, Inc., a New York corporation, but also by the deductions allowed to the transferor of said corporation, namely, Artemas Ward, an individual.

(3) The Board erred in holding that no loss was sustained by said Artemas Ward, Inc., a New York corporation, by reason of the cancellation of its contract with Interborough Rapid Transit Company on November 1, 1925.

[fol. 63] (4) The Board erred in holding that there was a deficiency in tax for the year 1925 in the amount of $485.02.

Errors Affecting the Year 1926

(1) The Board erred in holding that the loss sustained by United Brokerage Company in 1926 upon the sale of the stock of Artemas Ward, Inc., a New York corporation, should be computed in accordance with the provisions of

Article 1599 of Regulations 69, as amended and revised on November 13, 1929.

(2) The Board erred in failing to hold that the provisions of Article 1599 of Regulations 69, promulgated August 28, 1926, were legislative in character, and therefore could not be changed by the Commissioner of Internal Revenue, with or without the approval of the Secretary of the Treasury.

(3) The Board erred in failing to hold that the provisions of Article 1599 of Regulations 69, promulgated August 28, 1926, were legislative in character, and that to permit the retroactive amendment of such provisions at any time would be unjust, arbitrary, confiscatory, and violative of the Fifth Amendment to the Constitution.

(4) The Board erred in failing to hold that the provisions of Article 1599 of Regulations 69, promulgated August 28, 1926, were legislative in character, and that to permit the retroactive amendment of such provisions on November 13, 1929, after the expiration of the time within which such provisions might reasonably be changed, would be unjust, arbitrary, confiscatory and violative of the Fifth Amendment to the Constitution.

[fol. 64] (5) The Board erred in failing to hold that even though the provisions of Article 1599 of Regulations 69, promulgated August 28, 1926, are to be considered administrative or interpretive rather than legislative, the provisions of said article could not legally be changed after the reenactment of Section 204(a)(9) of the Revenue Act of 1926 in successive revenue acts.

(6) The Board erred in failing to hold that the loss sustained by United Brokerage Company in 1926 upon the sale of the stock of Artemas Ward, Inc., a New York corporation, should be computed in accordance with the provisions of sub-paragraph (1) of Article 1599 of Regulations 69, as promulgated on August 28, 1926.

(7) The Board erred in failing to hold that if such loss should not be computed in accordance with the provisions of sub-paragraph (1) of Article 1599 of Regulations 69, as promulgated on August 28, 1926, it should be computed in

accordance with the provisions of sub-paragraph (2) of such article as so promulgated.

(8) The Board erred in failing to hold that if such loss should not be computed in accordance with the provisions of either sub-paragraph (1) or sub-paragraph (2) of Article 1599 of Regulation 69, as promulgated August 28, 1926, it should be computed in accordance with the provisions of Section 201(d) of the Revenue Act of 1926.

(9) The Board erred in holding that there was a deficiency in tax for the year 1926 in the amount of $299.94.

[fol. 65] Wherefore, the petitioner asks that the decision of the Board of Tax Appeals be reviewed by the United States Circuit Court of Appeals for the Second Circuit; that a transcript of the record be prepared in accordance with law and with the rules of said Court and transmitted to the clerk of said Court for filing, and that appropriate action be taken to the end that the errors complained of may be reviewed and corrected by said Court.

(Signed) Laurence Graves, 295 Madison Avenue, New York, N. Y. (Sgd.) Arthur M. Kracke, The Rookery, Chicago, Illinois, Counsel for Petitioner.

Duly sworn to by Laurence Graves. Jurat omitted in printing.

[fol. 66] BEFORE UNITED STATES BOARD OF TAX APPEALS

[Title omitted]

PRÆCIPE FOR TRANSCRIPT OF RECORD—Filed Aug. 7, 1934

To the Clerk of the United States Board of Tax Appeals:

You are requested to prepare and certify and transmit to the Clerk of the United States Circuit Court of Appeals for the Second Circuit, with reference to the petition for review heretofore filed by the petitioner in the above cause, a transcript of the record in the above cause, prepared and transmitted as required by law and by the rules of said court, and to include in said transcript of record the following documents or certified copies thereof, to wit:

1. The docket entries of all proceedings before the Board of Tax Appeals.

2. The pleadings before the Board.

3. The stipulation of facts.

[fol. 67] 4. Opinion of the Board of Tax Appeals.

5. The decision of the Board.

6. The petition for review.

7. This præcipe.

Laurence Graves, Attorney for Petitioner, 618 Southern Building, Washington, D. C.

Personal service of the foregoing præcipe is hereby acknowledged this 7th day of August, 1934.

Robert H. Jackson, Assistant General Counsel for the Bureau of Internal Revenue, Attorney for Respondent.

[fol. 68] Clerk's Certificate to foregoing transcript omitted in printing.

[fol. 69] UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

MANHATTAN GENERAL EQUIPMENT CO., Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE, Respondent

SECOND CIRCUIT

COLLIER SERVICE CORPORATION, Formerly SUBWAY ADVERTISING CO., INC., Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE, Respondent

Before: Manton, Augustus N. Hand and Chase, Circuit Judges

Petitions for review of decisions of the United States Board of Tax Appeals.

From orders of the Board of Tax Appeals deciding that there were income tax deficiencies of the Manhattan General Equipment Company for the years 1925 and 1926 in the amounts of $485.02 and $299.94, respectively, and of Collier Service Corporation for the years 1925 and 1926 in the amounts of $6,396.22 and $42,344.51 respectively. Affirmed.

The petitioners are affiliates of United Brokerage Company. That corporation filed income tax returns for itself and [fol. 70] its affiliates for 1925 and 1926 and the petitioners seek to review tax deficiencies attributed to them by the Commissioner, which the Board of Tax Appeals has affirmed. For a number of years prior to March 1, 1913, Artemas Ward owned a contract, controlling advertising, vending and news selling privileges within cars and stations of the subways and elevated railways of the Interborough Rapid Transit Company in New York City, which the Commissioner of Internal Revenue determined had a value of $3,028,096.42 on that date. The contract by its terms was to continue in existence until December 31, 1928.

On March 13, 1922, Artemas Ward transferred his contract with the Interborough Rapid Transit Company to

Artemas Ward, Inc., a New York corporation, in exchange for all of its stock. On June 30, 1925, the United Brokerage Company purchased for $3,414,345.63 in cash all the capital stock of Artemas Ward, Inc., that was issued and outstanding consisting of 4,964 shares of no par value. On November 1, 1925, the New York Transit Commission cancelled the Interborough contract.

In assessing the income taxes for the year 1925 for United Brokerage Company and in order to ascertain whether there was any loss during that year caused by the cancellation of the contract, the Commissioner of Internal Revenue allowed as deductions on account of the exhaustion of the March 1, 1913 value of the contract between that date and March 13, 1922, when Artemas Ward assigned it to Artemas Ward, Inc., (New York) the sum of $1,726,560.76 and allowed as deductions between March 13, 1922, and November 1, 1925, when it was cancelled by the Transit Commission, the sum [fol. 71] of $1,730,578.36. If both sums be allowed, the United Brokerage Company has suffered no loss from the cancellation of the contract for they exceed $3,028,096.42, the March 1, 1913, value which was the base. The United Brokerage Company filed a return for the year 1925 for itself, the petitioners and other affiliates. It claims as a loss due to the cancellation of the contract the difference between the base of $3,028,096.42 and the sum of $1,730,578.38 allowed for exhaustion between the date of acquisition on March 13, 1922 and the date of cancellation on November 1, 1925, or $1,297,518.06. The question whether this sum should be allowed as a loss is the first point raised on these appeals.

On December 31, 1925, pursuant to a plan of reorganization, Artemas Ward, Inc. (N. Y.) transferred to Artemas Ward, Inc. (a Delaware corporation), in exchange for 100 shares of stock of the latter company of no par value, all its assets, then of a net book value of $1,246,920.07, with the exception of cash and accounts receivable aggregating $284,967.21—that is to say, the New York corporation transferred to the Delaware corporation assets of the value of $961,952.86. Immediately after the transfer, and on December 31, 1925, Artemas Ward, Inc. (N. Y.) distributed to United Brokerage Company the 100 shares of stock of Artemas Ward, Inc. (Del.) and accounts receivable amounting to $234,967.21. In December, 1926, United Brokerage

sold the entire 4,964 shares of Artemas Ward, Inc. (N. Y.) for $49,640. That stock had cost the United Brokerage $3,414,345.63 and the total must be apportioned between the 100 shares of the Delaware corporation (which it still owns) and the 4,964 shares of Artemas Ward, Inc. (N. Y.) in [fol. 72] order to determine the loss suffered by the United Brokerage Company through its sale of the 4,964 shares at $49,640. The Commissioner fixed the base value of the stock of the New York corporation after the reorganization, pursuant to Article 1599 (2) of Treasury Regulations 69 promulgated August 28 ,1926, as amended November 13, 1929. Article 1599 (2) (as amended) provided that:

"the cost or other basis of the stock in respect of which the distribution is made shall be apportioned between such stock and the stock or securities distributed in proportion, as nearly as may be, to the respective values of each class of stock or security, old or new, at the time of such distribution, * * *"

Upon the reorganization, the New York corporation had left among its assets, valued at $1,246,920.07, accounts receivable and cash aggregating $284,967.21, or approximately 22.85% thereof, after $961,952.86 had been transferred to the Delaware Company. Under Art. 1599 (2) supra, the portion of $3,414,345.63 paid by the United Brokerage Company for the stock of Artemas Ward, Inc. (N. Y.) represented by that stock after the reorganization was $780,303.97. If from this be deducted $234,967.21 accounts receivable and the $49,640 realized from the sale in December, 1926, there would be a loss of $495,696.76. This loss the Commissioner allowed in assessing the income tax for 1925. The second point raised on this appeal is whether the loss, for the year 1926, to which the United Brokerage Company and its affiliates were entitled was only the sum of $495,696.76 or was the sum of $2,167,785.56 which would arise through deducting from $3,414,345.63, (the cost of the stock of the New York company) the value [fol. 73] at the time of the reorganization of the Delaware stock which was $961,952.86 and $234,967.21 realized from accounts receivable and $49,640 realized from sale of the 4964 shares.

Laurence Graves and A. M. Kracke, Attorneys for petitioners, Caruthers Ewing, Counsel.

Frank J. Wideman, Assistant Attorney General for respondent; Sewall Key and Helen R. Carloss, Special Assistants to the Attorney General, Counsel.

AUGUSTUS N. HAND, Circuit Judge:

The first question before us is whether there was any deductible loss in 1925 because of the cancellation of the contract between Artemas Ward and Interborough Rapid Transit on November 1, 1925. This depends on whether the deductions for exhaustion allowed to Artemas Ward between March 1, 1913, and March 13, 1922, when the latter transferred the contract to Artemas Ward, Inc. (N. Y.) in exchange for all the stock of that corporation should be added to the deductions for exhaustion allowed to Artemas Ward, Inc. (N. Y.) between the date of transfer and the time of cancellation. If the allowances granted to Artemas Ward and to his transferee Artemas Ward, Inc. (N. Y.) may all be taken into account, no part of the March 1, 1913, value of the contract would remain, so that there would be no deductible loss due to the cancellation on November 1, 1925.

[fol. 74] The contract transferred by Artemas Ward to Artemas Ward, Inc. (N. Y.) was acquired by the latter pursuant to such a non-taxable exchange as is described in Section 203 (b) (4) of the Revenue Act of 1926 which provides that:

"(4) No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock * * * in such corporation, and immediately after the exchange such person or persons, are in control of the corporation; * * *."

Section 204 (a) of the same Act provides that:

"The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of said property; except that—

"(8) If the property * * * was acquired after December 31, 1920, by a corporation by the issuance of its stock * * * in connection with a transaction described in paragraph (4) of subdivision (b) of Section 203 * * *, then the basis shall be the same as it would be in the hands

of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made;"

In spite of the fact that the transfer of the contract from Artemas Ward to Artemas Ward, Inc. (N. Y.) was under Section 203 (b) (4) supra a non-taxable exchange and the basis for determining the disposition of the contract was under Section 204 (a) (8) the same as it would be in the [fol. 75] hand of the transferor, the petitioners argue that the basis should only be diminished by the amount of the deductions for exhaustion which were allowable after Artemas Ward, Inc. (N. Y.) acquired the contract. This argument is founded on Section 202 (b) of the Act of 1926 which says that in computing the amount of gain or loss from the disposition of property:

"(2) The basis shall be diminished by the amount of the deductions for exhaustion, wear and tear, obsolescence, amortization and depletion which have since the acquisition of the property been allowable in respect of such property under this Act or prior income tax laws;"

The petitioners contend that the word "acquisition" means acquisition to the taxpayer. But where there has been a non-taxable exchange we think the "acquisition" referred to is that of the transferor. It is impossible to see why different rules should be employed for determining profit or loss where items of exhaustion are or are not allowable and where property that has been the subject of a non-taxable exchange is sold or otherwise disposed of. The purpose of the statutory provisions we have quoted was to disregard the corporate intervention when computing gain or loss in such cases. Under Section 204 (a) (8) the basis is "the same as it would be in the hands of the transferor increased in the amount of gain and decreased in the amount of loss recognized to the transferor." To allow deductions for exhaustion under a different principle or in a more limited way would contravene the entire theory ap- [fol. 76] plicable to non-taxable exchanges. Perthur Holding Corp. v. Commissioner, 61 Fed. (2d) 785, (C. C. A. 2); American Compress & Warehouse Co. v. Bender, 70 Fed. (2d) 655. The Board of Tax Appeals properly took into

account items allowed for exhaustion when the contract was in the hands of the transferor and rightly disallowed any loss through cancellation because the value had already been exhausted.

It is now necessary to deal with the second point raised by the taxpayer. That is whether the loss on the sale of the 4,964 shares of Artemas Ward, Inc. (N. Y.) which the United Brokerage Company and its affiliates were entitled to was $2,167,785.56 as claimed, or was only $495,696.76, the loss allowed by the Board. This depends on what portion of the amount paid for the stock by United Brokerage Company is allocable to the stock of Artemas Ward, Inc. (N. Y.) and what portion to the stock of Artemas Ward, Inc. (Del.). This in turn depends on whether Article 1599 (2) of Regulations 69 should be applied in its original form or as it stood after amendment in 1929.

Section 203 (c) of the Act of 1926 provides that, if there is distributed, to a shareholder in a corporation, a party to a reorganization, stock in such corporation or in another corporation, a party to the reorganization, without the surrender by the shareholder of the stock originally held, no gain to the stockholder shall be recognized. Section 204 (a) (9) provided that where (as here) such distribution was made after December 31, 1923, "the basis, in the case of the stock in respect of which the distribution was made shall be apportioned, under rules and regulations prescribed by the Commissioner with the approval of the Secretary, between such stock and the stock or securities distributed."

The question is whether Article 1599 (2) supra applies in [fol. 77] its earlier form or as later amended on November 13, 1929. Before the amendment, Article 1599 (2) read thus:

"Where the stock distributed in reorganization is in whole or in part of a character or preference materially different from the stock in respect of which the distribution is made, the cost or other basis of the old shares of stock shall be divided between such old stock and the new stock in proportion, as nearly as may be, to the respective values of each class of stock, old and new, at the time the new shares of stock are distributed, and the basis of each share of stock will be the quotient of the cost or other basis of the class with which such share belongs, divided by the number of shares in the class. The portion of the cost or other

basis of the old shares of stock to be attributed to the shares of new stock shall in no case exceed the fair market value of such shares as of the time of their distribution."

Where the new stock is stock of a corporation different from the old, it has been treated as stock of "a character or preference materially different" within the meaning of the foregoing regulation. Accordingly, if Article 1599 (2) as it read at the time of the sale of the 4,964 shares of Artemas Ward, Inc. (N. Y.), be applied, the last sentence of (2) would entitle the United Brokerage Company to a loss of $2,167,785.56. This is because the portion of the cost of the old stock to be attributed to the new stock could not exceed the fair market value of the 100 shares of stock of [fol. 78] Artemas Ward, Inc. (Del.), at the time of the distribution of the latter. As we have shown in the statement of facts the value of the latter stock at that time was $961,952.86. If $961,952.86 be deducted from $3,414,345.63 (the cost of the shares of Artemas Ward, Inc. (N. Y.), to United Brokerage Company) there would remain $2,452,-392.77 as the base or proportion of the cost of the old stock applicable thereto after the reorganization. If from $2,452,-392.77 be deducted $234,967.21 of accounts receivable distributed by Artemas Ward, Inc. (N. Y.), to United Brokerage Company, and $49,640 realized by the Untied Brokerage Company from the sale of the 4,964 shares of stock of Artemas Ward, Inc. (N. Y.), we have a balance amounting to $2,167,785.56—the loss claimed by the taxpayer.

Limitation by the last sentence of Subd. (2) supra to the fair value of stock of Artemas Ward, Inc., (Del.) at the time of distribution would make the proportion of cost to United Brokerage Company represented by that stock only about 28%, though the Delaware Company had received 77.15% of the assets of the old company. Doubtless, because such a limitation was thought to attribute in situations like the present too small a proportion of the basic cost to the stock of the new corporation distributed to stockholders through a reorganization, the Commissioner amended Article 1599 (2) on November 13, 1929, by omitting the last sentence of Subdivision (2). Applying the regulation as amended, he computed the loss on the sale of the stock of Artemas Ward, Inc., (N. Y.) at $495,696.76. The Board by employing that loss in determining the income of

the affiliated corporations arrived at the income tax de-
[fol. 79] ficiencies under review. We cannot see that the method of apportionment required by the amendment was unreasonable and if the Commissioner had the right to apply the Regulation, as amended in 1929, to prior transactions under which the taxpayers would be entitled to deduct a larger loss, the decisions of the Board were right.

The taxpayers argue that the Commissioner had no right to apply the Regulations, as amended, to prior transactions and cite Arizona Grocery v. Atchison Ry., 284 U. S. 370, in support of their contention. But Gt. Northern Ry. v. Sunburst Co., 287 U. S. 358, indicates that the former decision does not govern the present situation. The latter decision shows that if under power to adopt Regulations delegated by Congress to the Commissioner authority is given to change the Regulations, the Regulations are to the extent of that power tentative as to any matters affected, and that the changed Regulations, if reasonable, may be applied retroactively. In Gt. Northern Ry. v. Sunburst, 287 U. S. 358, this principle was applied in the case of freight rates which had been charged under a power to fix and to change the same delegated by the State of Montana to its Board of Railroad Commissioners. The rates were afterwards lowered by the State Board and the shipper was allowed to recover the excess from the carrier. In Titsworth v. Commissioner, 73 Fed. (2d) 385, (C. C. A. 3) the very argument presented here of the inability of the Commissioner to apply amended Article 1599 (2) retroactively was made without avail. Cf. Burnet v. S. & L. Bldg. Corp., 288 U. S. 406.

There can be no doubt that Congress has power to make
[fol. 80] income tax laws retroactive. Brushaber v. Union Pac. Ry., 240 U. S. 11. This is especially true where they only affect deductions that may be taken from income, which are always matters of legislative favor. Under the Revenue Acts of 1924 and 1926 the Commissioner was given discretion to apply his regulations without retroactive effect if the reversal of a former ruling was not immediately occasioned by a decision of a court of competent jurisdiction. Act of 1924, § 1008 (a); Act of 1926, § 1108 (a). Under the Act of 1928, § 605 (c), the Commissioner was given the same discretion without the limitation as to how the change in his former ruling was occasioned. Under the Act

of 1934, § 506, the 1982 provision was practically reiterated. Each of these enactments shows that the Regulations of the Commissioner are to be regarded as tentative for the reason that amendments are retroactive unless stated to be otherwise. Accordingly the Regulations in question are to be treated as retroactive to the date of the law to which they are applicable.

Orders affirmed.

Manton, J., dissenting in a separate opinion.

[fol. 80½] [Endorsed:] United States Circuit Court of Appeals. Second Circuit. Manhattan General Equipment Co., against Commissioner of Internal Revenue. Collier Service Corporation, etc., against Commissioner of Internal Revenue. Opinion. Augustus N. Hand, C. J.

[fol. 81] UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

MANHATTAN GENERAL EQUIPMENT CO., Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE, Respondent.

COLLIER SERVICE CORPORATION, Formerly SUBWAY ADVERTISING CO., INC., Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE, Respondent.

MANTON, Circuit Judge (Dissenting).

This appeal involves income taxes for 1925 and 1926, of both petitioners. The questions presented are (1) where a corporation which acquired a contract in a nontaxable exchange for stock pursuant to a transaction described in § 203 (b) (4) of the Revenue Act of 1926, and hence under § 204 (a) (8), is required to use the basis of the transferor in measuring the loss from the cancellation of that contract, should that basis be reduced by the amount of deductions for exhaustion allowable to the corporation taxpayer only or by the total exhaustion allowable to both the taxpayer and the transferrer; and (2) whether the loss sustained in 1926

on the sale of stock, received in a non-taxable distribution [fol. 82] in pursuance of a plan of reorganization, should be determined upon the basis of regulations in effect in 1926 (Art. 1599, Regulations 69), or upon the basis of an amended regulation promulgated in 1929 (Art. 1599, Regulations 69).

Artemus Ward, prior to March 1, 1913, had a contract for advertising, vending and news selling privileges on the cars and stations of the subways and elevated railways of the Interborough Rapid Transit Co. The fair value of this contract was appraised by the Commissioner, as of March 1, 1913, at $3,028.096.42. March 13, 1922, Artemus Ward transferred this contract to a New York corporation, Artemus Ward Inc., in exchange for the stock of the corporation. The United Brokerage Company which filed a consolidated return with the petitioners, purchased the entire issued and outstanding capital stock of Artemus Ward Inc., consisting of 4,964 shares of no par value, on June 30, 1925, for $3,414,345.63. This contract was cancelled November 1, 1925. In the consolidated return filed by the United Brokerage Co. for 1925, the income and deductions of Artemus Ward Inc. were included for the period of July 1 to December 31, 1925. One deduction claimed by Artemus Ward Inc. was a loss resulting from the cancellation of the contract, and it was disallowed by the respondent. In the petition filed with the Board, petitioner claimed a deduction for the loss sustained, in the sum of $605,619.30. This was computed by reducing the March 1, 1913 valuation of $3,028,096.42 by annual deductions for the exhaustion of the life of the contract on the basis of a remaining life on March 1, 1913 of 15 5/6 years. The exhaustion so computed [fol. 83] amounted to $2,422,477.12, leaving an unexhausted March 1, 1913 value of $605,619.30. The respondent computed the amount of exhaustion allowable both to the transferor Artemus Ward, the individual, and to the transferee, Artemus Ward Inc., in terms of March 1, 1913 value, at the rate of $191,248.20 per year, except in 1922 and 1923, when an allowance was permitted for exhaustion of the contract in the amount of $766,642.59 for each of the two years. The deductions allowable for exhaustion of the contract during the period it was owned by Artemus Ward Inc. were $613,-314.07 for 1922, and $766,642.59 for 1923, based upon the

value at the date of the acquisition of the contract by Artemus Ward, Inc. on March 13, 1922.

The plan of reorganization referred to in the prevailing opinion became effective during 1925, and in 1926, the United Brokerage Co. sold the shares of Artemus Ward Inc. (N. Y.) for $49,640.

In its return for 1926, the United Brokerage Co. claimed a deduction of $3,062,314.54 as a loss resulting from the sale of the stock of Artemus Ward Inc. (N. Y.). This loss was computed in accordance with the provisions of subdiv. (1) of Art. 1599, Regulations 69, then in effect for sales made in 1926. But the respondent applied the provisions of Art. 1599 (2) of Regulations 69, as amended November 13, 1929, and determined the loss sustained to be $495,696.76. The distribution to the United Brokerage Co. on December 31, 1925, of the stock of Artemus Ward Inc. (Del.), worth $961,952.86 and accounts receivable worth $234,967.21 was followed, in December 1926, by the sale of the stock of the Artemus Ward Inc. (N. Y.) for $49,640 and this made it possible to ascertain the amount of the loss which had been [fol. 84] sustained by the parent company. It paid $3,414,345.63 for the stock of the New York corporation, and it received assets worth only $1,246,560.07 and therefore suffered a loss of $2,167,785.56 on the transaction.

Pursuant to § 204(a) (8), the basis for determining the gain or loss from the sale of the contract in the hands of Artemus Ward Inc. was the same as it would be in the hands of Artemus Ward the transferor—$3,028,086.42. The reason the loss sustained by cancellation of the contract was disallowed, was that the aggregate amount of the deductions allowed or allowable for the exhaustion of the contract to Artemus Ward, the transferor, from March 1, 1913 to March 13, 1922, and to Artemus Ward Inc. subsequent to the time said contract was acquired by it on March 13, 1933, and prior to November 1, 1925, was in excess of the basis of $3,028,096.42. Under the provisions of § 202(b) (2) of the Revenue Act of 1926, the basis to Artemus Ward Inc. of $3,028,096.42 is reduced only by the aggregate of deductions allowable to it for exhaustion of such contract during the period the contract was owned by it. The aggregate amount of the deductions allowable to it for the exhaustion was $1,730,578.36; thus Artemus Ward Inc. suffered a loss of $1,297, 518.06. The value of this contract

to the transferee, Artemus Ward Inc., must be computed undiminished by any exhaustion allowed or allowable to the transferor, Artemus Ward. It should not include any deductions for exhaustion which may have been allowed or allowable to the transferor Artemus Ward prior to March 13, 1922.

[fol. 85] Section 203(c) of the Revenue Act of 1926 provides that if there was distributed to a shareholder in a corporation a party to a reorganization, stock in such corporation or in another corporation a party to the reorganization, without the surrender of the stock originally held, no gain to the shareholder should be recognized. Section 204 (a) (9) provides that in such cases the basis of the old stock should be apportioned between the old and new stock under rules and regulations prescribed by the Commissioner. Regulations 69, Art. 1599, promulgated August 28, 1926, provided that where the new stock was of substantially the same character or preference as the old stock, the basis of each share should be determined by dividing the cost of the old stock by the total number of old and new shares. Paragraph 2 provided that where the new stock was of a character or preference materially different from the old stock, the cost of the latter should be divided between the old and the new stock in proportion to the respective values of each class of stock at the time of distribution, but with the proviso that the basis of the old shares of stock to be attributed to the new stock shall in no case exceed the fair market value of such shares as of the time of their distribution. Thus, if the allocation is to be made under para. 2 of Art. 1599, the cost of the old stock should be divided between the old and the new in proportion to the respective values of each class; the amount to be attributed to the new stock not to exceed the value of such stock under the limitation contained in the article as then promulgated. The value of the new stock was $961,952.86; the remainder of the [fol. 86] cost of $3,414,345.63, that is, $2,452,392.77, should be allocated to the old stock, and after deducting the accounts receivable and the sum received when the old stock was sold, there was a loss of $2,167,785.56. This is the actual loss sustained by the United Brokerage Co. as shown in the statement of facts.

The prevailing opinion holds that the original article is inapplicable by reason of the promulgation, on November

13, 1929, of an amendment to Art. 1599 of Regulations 69, providing explicitly that where the stock distributed was stock in a corporation other than the distributing corporation, the basis of the old stock should be apportioned under para. 2 of the article, omitting the last sentence of the original article. The prevailing opinion thus applies the amended article to the distribution made by Artemus Ward Inc. on December 31, 1925, retroactively. Great Northern Ry. v. Sunburst Co. (287 U. S. 358) is relied upon.

In Arizona Grocery Co. v. Atchison, T. & S. F. Ry. Co. (284 U. S. 370), the holding of the court was that when the Interstate Commerce Commission declares a certain rate to be a reasonable rate, it speaks as the legislature and its pronouncement has the force of a statute, the Interstate Commerce Commission in naming the rate, speaking in a quasi-legislative capacity. This being so, the court held that the Interstate Commerce Commission cannot, by a later provision, declare its own finding of reasonableness to be erroneous and subject a carrier which conformed thereto, to a reparation measured by what the Interstate Commerce Commission later holds it should previously have [fol. 87] decided. The Great Northern Ry. case (supra), in no way changed this holding. In that case, the court held that where it is clear to all concerned that a rate as fixed is but tentative and provisional, the rate may be changed retroactively. The court found that notice had been given to all that the rate was subject to retroactive change. The court said that the Arizona case (supra), was not in conflict with such view, because Congress had not there intended that the Interstate Commerce Commission have power to change rates retroactively. The Great Northern case in no way implied, as might be concluded from the prevailing opinion, that the mere power to change regulations makes such regulations only tentative, and therefore capable of being applied retroactively when changed. The very "meat" of the Great Northern case was that all concerned knew and understood that the rates, as fixed, were originally tentative, not that they were simply subject to change. Where regulations are only subject to change, but are not understood to be tentative, the Arizona case (supra) applies, and they cannot be applied retroactively.

Prior to the enactment of the 1926 Act, the authority of the Commissioner arbitrarily to decide whether or not later

regulations were to be applied retroactively was seriously questioned. As a result, the Act of 1926 (§1108[a]) gave the Commissioner a wide discretion. The discretion was not to apply it with retroactive effect, but without retroactive effect. The 1928 Act is in the same terms (§605, Act of 1928). "The purpose of the above provision of law is to prevent the constant reopening of cases on account of [fol. 88] changes in regulations or treasury decisions." Prentice-Hall Tax Service (1934) §21,207. The 1934 Act (§506) provides that the Secretary or Commissioner, with the former's approval, may prescribe the extent, if any, to which any regulation shall be applied "without retroactive effect". See: Report Ways & Means Committee, 1934.*

The retroactivity of an amended regulation may depend upon whether the regulation under discussion declares the law or merely interprets it. If the latter, then the regulation, in reality, has no retroactive effect of itself. [fol. 89] The regulation would be only interpretive of the statute which imposes the tax. If, on the other hand, it is declarative of the law, then the amended regulation might well be invalid if it adversely and unjustly affected the taxpayer. The Report of the Ways and Means Committee recognized the distinction and also that those regu-

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* "The amendment tends the right granted by existing law to the Treasury Department to give regulations and Treasury Decisions amending prior regulations or treasury decisions prospective effect only, by allowing the Secretary, or the Commissioner with the approval of the Secretary, to prescribe the exact extent to which any regulation or Treasury decision, whether or not it amends a prior regulation or treasury decision, will be applied without retroactive effect. * * *" "*Regulations, * * * which are merely interpretive of the statute, will normally have a universal application, but in some cases the application of regulations, * * *, to past transactions which have been closed by taxpayers in reliance upon existing practice, will work such inequitable results that it is believed desirable to lodge in the Treasury Department the power to avoid these results by applying certain regulations, * * * with prospective effect only.*" [Prentice-Hall Federal Tax Service, (1935) §21, 207.]

lations which are of a nature other than merely interpretive, often work inequitable results when applied retroactively. This fact, which was considered a reason for giving the Commissioner discretion to apply regulations non-retroactively, is also a reason for refusing to give a retroactive effect to an amended regulation even though the Commissioner does not exercise his discretion.

Congress di dnot declare, in § 204 (a) (9), the method by which the basis should be apportioned. Rather, it delegated to the Commissioner the power to make rules and regulations for such apportionment with the approval of the Secretary. To say that the Commissioner is merely interpreting the law in such case, is erroneous. Before the Commissioner promulgated Article 1599 of Regulation 69, there was no law in regard to the method to be used in apportioning the basis, and the Commissioner, when he promulgated the article, made the law. The Regulation was not interpretive of the law, because before the Regulation there was no law. The Commissioner acted in what the Supreme Court, in the Arizona Grocery case, supra, called a quasi-legislative manner. Regulations made by the Commissioner in pursuance of his delegated authority, with the Secretary's approval, have the force and effect of statutes. U. S. v. Eliason, 16 Pet. 291; In re Huttman, 70 Fed. 699. And [fol. 90] so, when the Commissioner, in accordance with his delegated power, acts in behalf of Congress in enacting such a regulation as is considered in the instant case, the regulation promulgated by him will be considered declarative of the law, and quasi-legislative in nature. Consequently, the regulation should not be applied with retroactive effect. To do so would be unreasonable and capricious. Untermyer v. Anderson, 276 U. S. 440; Nichols v. Coolidge, 274 U. S. 531; Arizona Grocery Co. v. Atchison, T. & S. F. Ry. Co., supra.

The deduction should be allowed and the decision reversed.

[fol. 90½] [Endorsed:] United States Circuit Court of Appeals, Second Circuit. Manhattan General Equipment v. Commr. of Internal Revenue. Dissenting Opinion. Manton, Circuit Judge.

[fol. 91] UNITED STATES CIRCUIT COURT OF APPEALS, SECOND CIRCUIT

At at Stated Term of the United States Circuit Court of Appeals, in and for the Second Circuit, held at the Court Rooms in the Post Office Building in the City of New York, on the 22nd day of April, one thousand nine hundred and thirty-five.

Present: Hon. Martin T. Manton, Hon. Augustus N. Hand, Hon. Harrie B. Chase, Circuit Judges.

Appeal from the United States Board of Tax Appeals

This cause came on to be heard on the transcript of record from the United States Board of Tax Appeals; and was argued by counsel.

On consideration whereof, it is now hereby ordered, adjudged, and decreed that the order of said United States Board of Tax Appeals be and it hereby is affirmed.

It is further ordered that a Mandate issue to the said Board in accordance with this decree.

Wm. Parkin, Clerk.

[fol. 92] [Endorsed:] United States Circuit Court of Appeals, Second Circuit. Manhattan General Equipment Co. vs. Commissioner of Internal Revenue. Order for Mandate. United States Circuit Court of Appeals, Second Circuit. Filed April 22, 1935. William Parkin, Clerk.

[fol. 93] [Stamp:] United States Circuit Court of Appeals, Second Circuit. Filed Apr. 29, 1935. William Parkin, Clerk.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

MANHATTAN GENERAL EQUIPMENT COMPANY, Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE, Respondent

COLLIER SERVICE CORPORATION, Formerly Subway Advertising Co., Inc., Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE, Respondent

On Petitions for Review of Decisions of the United States Board of Tax Appeals

PETITION FOR A REHEARING

Come now the petitioners, Manhattan General Equipment Company and Collier Service Corporation, formerly Broadway Subway Advertising Co., Inc., by their attorneys, and petition this honorable court for a rehearing in the above entitled causes in which the opinions were filed on April 15, 1935. In support of this petition petitioners assign the following reasons:

[fol. 94] (1) The finding of this court that the loss sustained by United Brokerage Company as a result of the sale in December, 1926, of 4,964 shares of Artemas Ward, Inc. (N. Y.) should be determined under Article 1599 (2) of Regulations 69 as amended November 13, 1929 was based upon Great Northern Railway Company v. Sunburst Oil and Refining Company, 287 U. S. 358, which was not cited or relied upon by either of the parties in the proceedings before this honorable court, and with respect to which the petitioners have not had an opportunity to give this honorable court the benefit of their views regarding the inapplicability of that decision to the issue presented in these proceedings.

(2) It is the view of the petitioners that the application by this court of the decision in Great Northern Railway Co. v. Sunburst Oil and Refining Company, supra, was erroneous in at least two respects.

(a) It was implied that the United States Supreme Court had approved the retroactive amendment of quasi-legislative regulations, whereas that court definitely declined to express any opinion upon the legality of such amendments.

The Board of Railroad Commissioners of Montana had made a retroactive change in the rates for the carriage of freight, and the respondent had recovered a judgment against the complainant which was affirmed upon appeal. In an earlier case, Doney v. Northern Pacific Railway Co., 60 Mont. 209, 199 Pac. 432, which had been decided prior to the collection of the charges complained of in the Great Northern case, the Montana Supreme Court had indicated [fol. 95] that such actions for restitution might be maintained against the carrier, under certain conditions, if the Board determined retroactively that the rates were excessive. The United States Supreme Court held that this earlier decision had written into the Montana statute a notice to all concerned that payments exacted by a carrier were subject to be refunded if found thereafter to be excessive, and that no Federal right was infringed by giving to the statute the meaning that had been ascribed to it by the Montana court, since no such impairment would have resulted if the meaning had been written into the statute by the legislature. The United States Supreme Court did not endorse the interpretation placed upon the statute by the Montana court, but held that the meaning of the Montana statute was a problem for the Montana courts, and not subject to review by itself.

(b) It was implied that the Supreme Court of Montana had approved the retroactive amendment of quasi-legislative regulations, whereas although that court had approved such amendment in an earlier decision, it held in this case that such retroactive amendments were wrong in principle and would not be sustained in the case of future transactions.

The case of Doney v. Northern Pacific Railway Co., supra, in which the court affirmed the shipper's right to recover charges held retroactively to be excessive, was decided in

1921. The transactions complained of in Great Northern Railway Co. v. Sunburst Oil and Refining Company, supra, occurred between August, 1926 and August, 1928. While the Montana Supreme Court held in that case that the ruling in the Doney case was law until reversed and would con- [fol. 96] stitute the governing principle for shippers and carriers who, during the period of its reign, had acted on the faith of it, the court nevertheless decided that the ruling in the Doney case was erroneous and would not be followed with reference to future transactions. The court further held that a rate established by the Commission had the same effect as one established by the legislature, and that the statute giving power to the Commission or the court to declare a rate unreasonable was not to be read as meaning that the declaration of invalidity should apply to intermediate or completed transactions, i. e., should not authorize retroactive changes in rates. The effect of the revised interpretation of the Montana statute announced by the Montana Supreme Court in this case as the principle to be applied with respect to future transactions, is identical with the interpretation placed upon the Federal statute by the United States Supreme Court in the case of Arizona Grocery Co. v. Atchison, Topeka and Santa Fe Railroad Company, 284 U. S. 370. Both of these courts have now in effect held that when an administrative agency declares a certain rate to be a reasonable rate it speaks as the legislature and its pronouncement has the force of statute, and such administrative body can not by a later amendment of its regulations declare its own finding to be erroneous, and subject a carrier which conformed thereto to reparation measured by its later declaration.

Laurence Graves, Southern Bldg., Washington, D. C.
Arthur M. Kracke, Rookery Bldg., Chicago, Ill.

[fol. 97] Certificate of Counsel

The undersigned counsel for petitioners hereby certify that in their judgment the foregoing petition is well founded and is not interposed for delay.

Laurence Graves, Arthur M. Kracke.

[fol. 98] UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

MANHATTAN GENERAL EQUIPMENT COMPANY, Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE, Respondent

COLLIER SERVICE CORPORATION, Formerly SUBWAY ADVERTISTISING CO., INC., Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE, Respondent

Before Manton, Augustus N. Hand and Chase, Circuit Judges

Laurence Graves, Esq., Arthur M. Krack, Esq., Counsel for Petitioners.

Per CURIAM:

Petition for rehearing denied.

——— ———, United States Circuit Judges.

Filed May 22, 1935.

[fol. 99] UNITED STATES CIRCUIT COURT OF APPEALS, SECOND CIRCUIT

At a stated term of the United States Circuit Court of Appeals, in and for the Second Circuit, held at the Court Rooms in the Post Office Building in the City of New York, on the 22nd day of May, one thousand nine hundred and thirty-five.

Present: Hon. Martin T. Manton, Hon. Augustus N. Hand, Hon. Harrie B. Chase, Circuit Judges.

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MANHATTAN GENERAL EQUIPMENT COMPANY, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

COLLIER SERVICE CORPORATION, Formerly SUBWAY ADVERTISING CO., INC.,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

A petition for a rehearing having been filed herein by counsel for the petitioners;

Upon consideration thereof it is

Ordered that said petition be and hereby is denied.

Wm. Parkin, Clerk.

[fol. 100] [Endorsed:] United States Circuit Court of Appeals, Second Circuit. Manhattan General Equipment Company v. Commissioner of Internal Revenue. Collier Service Corporation v. Commissioner of Internal Revenue. Order. United States Circuit Court of Appeals, Second Circuit. Filed May 22, 1935. William Parkin, Clerk.

[fol. 101] UNITED STATES OF AMERICA,
Southern District of New York:

I, William Parkin, Clerk of the United States Circuit Court of Appeals for the Second Circuit, do hereby certify that the foregoing pages, numbered from 1 to 100, inclusive, contain a true and complete transcript of the record and proceedings had in said Court, in the case of Manhattan General Equipment Company, Petitioner, against Commissioner of Internal Revenue, Respondent, as the same remain of record and on file in my office.

In testimony whereof, I have caused the seal of the said Court to be hereunto affixed, at the City of New York, in the Southern District of New York, in the Second Circuit, this first day of July, in the year of our Lord one thousand nine hundred and thirty-five, and of the Independence of the said United States the one hundred and fifty-ninth.

Wm. Parkin, Clerk. (Seal United States Circuit Court of Appeals, Second Circuit.)

[fol. 102] SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed October 14, 1935

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though field in response to such writ.

CLERK'S COPY.

TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1935

No. 227

COLLIER SERVICE CORPORATION, FORMERLY BROADWAY SUBWAY ADVERTISING CO., INC., PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

PETITION FOR CERTIORARI FILED JULY 8, 1935.

CERTIORARI GRANTED OCTOBER 14, 1935.

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1935

No. 227

COLLIER SERVICE CORPORATION, FORMERLY BROADWAY SUBWAY ADVERTISING CO., INC., PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

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JUDD & DETWEILER (INC.), PRINTERS, WASHINGTON, D. C., NOV. 14, 1935.

—7116-C

[fol. 1]

BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket No. 51372

COLLIER SERVICE CORPORATION, Formerly BROADWAY SUBWAY ADVERTISING CO., INC.,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

DOCKET ENTRIES

APPEARANCES:

For Petitioner: Laurence Graves, Esq., A. M. Kracke, Esq.

For Respondent: W. F. Gibbs, Esq.

Transferred to Mr. Murdock.

1930.

Dec. 17. Petition received and filed. Taxpayer notified. Fee paid.

" 17. Copy of petition served on General Counsel.

1931.

Feb. 10. Answer filed by General Counsel.

" 17. Copy served—assigned General Calendar.

1932.

Oct. 5. Hearing set November 15, 1932.

" 22. Motion for 60 days continuance filed by taxpayer. October 25, 1932 granted to January 16, 1933.

[fol. 2]

1933.

Jan. 16. Hearing had before Mr. C. R. Arundell, Division 7. Submitted on the merits. On petitioner's motion, consolidated with dockets 51,341 to 51,380, except 51,362 and 51,371. Oral amendment made to petition. Stipulation of facts filed. Briefs due March 15, 1933.

" 23—Transcript of hearing January 16, 1933 filed.

Nov. 23—Opinion rendered—J. E. Murdock, Division 3. Decision will be entered under Rule 50.

DOCKET ENTRIES—Continued

1934

Mar. 15—Stipulation as to deficiency filed.
" 20—Decision entered—Division 3.
June 1—Motion to fix amount of bond filed by taxpayer.
" 2—Order fixing amount of bond at $79,000 entered.
" 20—Petition for review by United States Circuit Court of Appeals, Second Circuit, with assignments of error filed by taxpayer.
" 20—Proof of service filed by taxpayer.
Aug. 7—Præcipe with proof of service thereon filed.
" 18—Order extending time for transmission and delivery of record to September 10, 1934 entered.

[fol. 3] BEFORE UNITED STATES BOARD OF TAX APPEALS

[Title omitted]

PETITION—Filed Dec. 17, 1930

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency IT:AR:A-5-HGF-60D, dated October 21, 1930, and as a basis for this proceeding alleges as follows:

1. The petitioner is a corporation with principal office at 220 West 42nd Street, New York, New York, organized under the laws of New York in May, 1915, with the name Broadway Subway and Home Borough Car Advertising Co., Inc., whose name was changed in March, 1924, to Broadway Subway Advertising Co., Inc., and again changed in October, 1928, to Collier Service Corporation.

2. The notice of deficiency (a copy of which is attached hereto and marked Exhibit A) was mailed to the petitioner on October 21, 1930.

3. The taxes in controversy are income taxes for the calendar years 1925 and 1926 and in the respective amounts of $7,109.71 and $42,497.21.

[fol. 4] 4. The determination of tax set forth in the said notice of deficiency is based upon the following errors:

(a) In the determination of the net income of Artemas Ward, Inc., a New York corporation, for the year 1925 as well as the consolidated net income, the total tax of the consolidated group and the proportion of such tax to be assessed upon the petitioner, the respondent has failed and refused to allow a deduction for the exhaustion of the March 1, 1913, fair market value or of the cost of a contract with the Interborough Rapid Transit Company in an amount not less than $63,749.40.

(b) In the determination of the net income of Artemas Ward, Inc., a New York corporation, for the year 1925 as well as the consolidated net income, the total tax of the consolidated group and the proportion of such tax to be assessed upon the petitioner, the respondent has failed and refused to allow a deduction for a loss sustained by reason of the cancellation of the contract with the Interborough Rapid Transit Company in an amount not less than $605,619.30, representing the unexhausted portion of the March 1, 1913, fair market value or of the cost of said contract.

(c) In the determination of the net income of United Brokerage Company, a Delaware corporation, for the year 1926 as well as the consolidated net income, the total tax of the consolidated group and the proportion of such tax [fol. 5] to be assessed upon the petitioner, the respondent has failed and refused to allow a deduction for losses sustained by reason of sales of the capital stock of Artemas Ward, Inc., a New York corporation, in the aggregate amount of $3,062,314.54. The aggregate amount allowed by the respondent on account of these losses is $495,696.76.

(d) In the determination of the net income for the year 1925 of the corporations hereinafter listed in this assignment of error, the respondent has failed and refused to allow deductions on account of the net losses of such corporations for the years 1923 and/or 1924, said net losses having been computed in the amounts set opposite their respective names, and the respondent has also erred in the determination of the consolidated net income, the total tax of the consolidated group, and the proportion of such tax to be assessed upon the petitioner, by reason of his failure to allow deductions on account of such net losses.

Name	Year 1923	Year 1924
United Brokerage Company (Del.)	$ ——	$207,799.89
Street Railways Advertising Company (Del.)	——	11,577.84
Street Railways Advertising Company (N. Y.)	55,190.96	27,660.81
Broadway Subway Advertising Co., Inc		175,003.34
Mark D. Batchelder Company	5,495.80	——
(Motor Coach Advertising Service, Inc. (Md.)		11,934.84
*(Bus Advertising Service, Inc. (Md.)	13,220.83	
(Motor Coach Advertising Service, Inc. (N. Y.)		
[fol. 6]		
*(Bus Advertising Service, Inc. (N. Y.)	7,102.65	7,193.09
A. H. Armstrong Company	——	867.42
Iroquois Advertising Company	1,521.96	——
Transit Sales Corporation	13,405.53	3,146.12
Standard Vending Corporation	5,881.28	8,849.-5
*(Advertising Samplers, Inc		
(National Vending Service, Inc	26,149.75	17,342.84
Interstate Sales Company	5,508.19	2,721.13
De Soto Paint Manufacturing Company	33,199.51	2,223.22
Quincy Warehouse Company	16,254.12	9,324.34
*(The Florida Railroad and Navigation Corporation.	58,800.58	304,425.11
(Florida Hotel and Navigation Company		
Florida Gulf Coast Hotels, Inc	32,126.03	42,396.78
Alexander, Ramsey & Kerr, Inc	——	2,029.79
(Island Realty Company		2,755.5–
*(Island Investment Company	650.33	
Deep Lake Company	216,553.75	38,469.57
(Neighborhood Stores Display Service, Inc		
*(Manufacturers Display Service Corp	10,429.84	6,843.29
Universal Vending Service Company	53,711.58	43,392.89
Luna Amusement Company	263,118.48	——
Crazy Village Amusement Corporation	5,894.32	——
Harum Scarum Amusement Corporation	17,406.03	——
Lee County Land Company	1,710.37	7,117.19
Gulf Coast Realties Corporation	207.81	——
Florida Timber Lands Corporation	687.32	4,321.32
The Barfield Company	2,489.84	——
Florida Development Company		26,117.20
Inter County Telephone & Telegraph Company		7,615.04

* Change of name.

[fol. 7] (e) In the determination of the net income for the year 1926 of the corporations hereinafter listed in this assignment of error, the respondent has failed and refused to allow deductions on account of the net losses of such corporations for the years 1924 and/or 1925, said net losses having been computed in the amounts set opposite their respective names, and the respondent has also erred in the determination of the consolidated net income, the total tax of the consolidated group, and the proportion of such tax to be assessed upon the petitioner, by reason of his failure to allow deductions on account of such net losses.

Name	Year 1924	Year 1925
United Brokerage Company (Del.)	$207,799.89	$237,982.09
Street Railways Advertising Company (N. Y.)	27,660.81	14,925.62
Broadway Subway Advertising Co., Inc	175,003.34	——
Mark D. Batchelder Company	——	1,294.66
Motor Coah Advertising Service, Inc. (Md.)	11,934.84	37,752.08
(Motor Coach Advertising Service, Inc. (N. Y.)		12.15
*(Bus Advertising Service, Inc. (N. Y.)	7,193.09	
A. H. Armstrong Company	867.42	1,415.64
Iroquois Advertising Company	——	1,294.30
Transit Sales Corporation	3,146.12	2,405.25
Standard Vending Corporation	8,849.95	8,369.19
(Advertising Samplers, Inc		25,195.03
*(National Vending Service, Inc	17,342.84	
Interstate Sales Company	2,721.13	1,922.11
Bus Advertising Service, Inc. (Del.)	——	280.83
Quincy Warehouse Company	9,324.34	3,499.48
[fol. 8]		
The Florida Railroad and Navigation Corporation	304,425.11	278,038.98
Florida Gulf Coast Hotels, Inc	42,396.78	54,536.64
Island Realty Company	2,755.56	570.29
Deep Lake Company	38,469.57	21,397.04
Advertising Service Corporation	——	32.—
(Neighborhood Stores Display Service, Inc		6,330.38
*(Manufacturers Display Service Corp	6,843.29	
Northwestern Advertising Company, Inc	——	31,783.35
Universal Vending Service Company	43,392.89	38,216.45
Crazy Village Amusement Corporation	——	7,580.15
Witching Waves Company	——	4,151.49
Harum Scarum Amusement Corporation	——	1,012.96
Lee County Land Company	7,117.19	74,069.56
Gulf Coast Realties Corporation	——	20,932.37
Florida Timber Lands Corporation	4,321.32	78,417.58
The Barfield Company	——	8,864.38
Florida Development Company	26,117.20	21,031.34
John Weiss, Inc., Photographers	——	118.31
Inter County Telephone & Telegraph Company	7,615.04	23,824.79
Everglades Publishing Company	——	2,433.34
Times Square Utilities Company, Inc	——	1,838.57

* Change of name,

(f) In the determination of the net income for the years 1925 and 1926 of the corporations hereinafter listed in this assignment of error, the respondent has failed to allow deductions on account of franchise taxes accrued within such years under the taxing statutes of the State of New York in the amounts set opposite their respective names and the respondent has likewise erred in the determination of the consolidated net income, the total tax of the consolidated [fol. 9] group, and the proportion of such tax to be assessed upon the petitioner, by reason of his failure to allow deductions on account of such franchise taxes.

Name	Year 1925	Year 1926
Barron G. Collier, Inc. (N. Y.)	$47,332.38	$2,803.22
Street Railways Advertising Company (N. Y.)	15.00	15.00
Empire State Advertising Company	155.93	25.00
Motor Coach Advertising Service, Inc.	10.00	10.00
Parker, Griesar & Savel, Inc.	10.00	56.25
Pacific Railways Advertising Company	10.00	10.00
Manhattan General Equipment Co.	500.00	500.00
The Tabard Press	4,220.87	4,204.26
Luna Amusement Company	3,408.53	4,196.03
Crazy Village Amusement Corporation	100.67	10.00
American Ammone Company	1,680.12	1,680.53

5. The facts upon which the petitioner relies as a basis of this proceeding are as follows:

(a) The petitioner during the years 1925 and 1926 was one of a group of corporations, affiliated within the meaning of the provisions of Section 240 of the Revenue Act of 1926 with the corporations hereinafter listed, the gross income and deductions of which were reported in a consolidated return for each of said years, filed by United Brokerage Company, a Delaware corporation, as provided by said section.

Name

United Brokerage Company (Del.)
Street Railways Advertising Company (Del.)
The Stearn Advertising Company of New York
[fol. 10] Barron G. Collier Inc. (N. Y.)
Barron G. Collier, Incorporated, of Texas
Street Railways Advertising Company (N. Y.)
Broadway Subway Advertising Co., Inc.
Empire State Advertising Company
Middle States Publicity Company, Inc.
Mark D. Batchelder Company
Motor Coach Advertising Service, Inc. (Md.)
Motor Coach Advertising Service, Inc. (N. Y.)
Motor Coach Advertising Service, Inc. (Ill.)
A. H. Armstrong Company
Southern Advertising Agency, Inc.
East St. Louis Car Advertising Co., Inc.
Iroquois Advertising Company
Western Car Advertising Company
Transit Sales Corporation
Standard Vending Corporation
Advertising Samplers, Inc.

Interstate Sales Company
Bus Advertising Service, Inc. (Del.)
*Ridgways, Incorporated
De Soto Paint Manufacturing Company
Quincy Warehouse Company
Parker, Griesar & Savel, Inc.
The Florida Railroad and Navigation Corporation
Florida Gulf Coast Hotels, Inc.
Alexander, Ramsey & Kerr, Inc.
Island Realty Company
Deep Lake Company
[fol. 11] Automatic Machine Development Corporation
Advertisers Service Corporation
*Listerated Gum Corporation
**Artemas Ward, Inc. (Del.)
*Artemas Ward, Inc. (N. Y.)
Street Railways Advertising Company (N. J.)
Western Advertising Company
Barron G. Collier, Incorporated, of Delaware
Chicago Elevated Advertising Company
Neighborhood Stores Display Service, Inc.
Inland Advertising Agency
Northwestern Advertising Company, Inc.
Universal Vending Service Company
Pacific Railways Advertising Company
The Stearn Advertising Company (Ohio)
Manhattan General Equipment Co.
The Tabard Press
Luna Amusement Company
Crazy Village Amusement Corporation
Witching Waves Company
Helter Skelter Slide Corporation
Harum Scarum Amusement Corporation
Oceanview Realty Operating Company, Inc.
Lee County Land Company
Gulf Coast Realties Corporation
Florida Timber Lands Corporation
Manhattan Mercantile Corporation

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* Included in the consolidated return of the year 1925 only.

** Included in the consolidated return of the year 1926 only.

The Barfield Company
Island Investment Company
[fol. 12] Florida Development Company
Philadelphia Advertising Company
John Weiss, Inc., Photographers
Inter County Telephone & Telegraph Company
Everglades Publishing Company
American Ammone Company
Times Square Utilities Company, Inc.
United Stores Land & Improvement Company
**Caloosahatchee Tropical Company

(b) The respondent has determined that the corporations listed in paragraph 5 (a) above were affiliated within the meaning of the Revenue Act of 1926 for the years 1925 and/or 1926 and were permitted to file consolidated returns of net income for such years, and has determined the tax liability of the consolidated group upon the basis of consolidated returns and has determined the proportion of such tax which should be assessed upon the petitioner for such years.

(c) From the date of the opening of the first subway in the City of New York in 1903 and for some time subsequent to March 1, 1913, the advertising, vending and news selling privileges within the cars and stations of the subways and elevated railways of the Interborough Rapid Transit Company and affiliated companies were owned or controlled by [fol. 13] Artemas Ward and William Gow as equal partners in the firm of Ward & Gow, or by Artemas Ward, individually, doing business under the style and name of Ward & Gow. Prior to March 1, 1913, the said Artemas Ward acquired the interest of said William Gow in the partnership of Ward & Gow. In the acquisition of this one-half interest, the said Artemas Ward paid said Gow the sum of $1,665,910.92 for Gow's interest in said contract with the Interborough Rapid Transit Company. The contract in existence on March 1, 1913, with the Interborough Rapid Transit was by its terms to continue in existence until December 31, 1918. Early in the year 1913 negotiations were entered into between said Artemas Ward and the Interborough Rapid

** Included in the consolidated return of the year 1926 only.

Transit Company for the purpose of obtaining an extension or continuance of the privileges existing under the contract for a period of ten years, or to December 31, 1928. For and in consideration of the agreement on the part of said Artemas Ward to pay during the years 1914 to 1918, inclusive, the sum of $1,150,000 more than was called for under the terms of the contract in existence at March 1, 1913, as well as the agreement of said Artemas Ward to pay certain specified rentals for the period from January 1, 1919 to December 31, 1928, the Interborough Rapid Transit Company agreed by an instrument dated December 27, 1913, to an extension or continuance of the privileges and obligations of said contract to December 31, 1928.

[fol. 14] (d) The fair market value of said contract on March 1, 1913, was not less than $3,028,096.42. In the final determination of the Federal income tax liability of said Artemas Ward for the years 1913 to 1920, inclusive, the respondent has determined that said contract had a March 1, 1913, fair market value of $3,028,096.42 and has allowed deductions in the computation of the net income of said Artemas Ward for each of such years on account of the exhaustion of such contract based upon such value.

(e) On March 13, 1922, the assets of said Artemas Ward, used in the conduct of his advertising, vending and news selling business, including the said contract with the Interborough Rapid Transit Company, were transferred to Artemas Ward, Inc., a New York corporation, in exchange for the stock of said corporation.

(f) On June 30, 1925, the issued and outstanding capital stock of said Artemas Ward, Inc., was acquired by United Brokerage Company, a Delaware corporation, one of the group of corporations listed in paragraph 5 (a) above.

(g) The contract between said Artemas Ward, Inc., and the Interborough Rapid Transit Company was terminated November 1, 1925, by the Transit Commission of the State of New York.

(h) In the determination of the net income of said Artemas Ward, Inc., for the period from July 1, 1925 to [fol. 15] December 31, 1925, the respondent has failed to allow a deduction on account of the exhaustion of the March 1, 1913, fair market value or of the cost of said contract for

the months of July, August, September and October prior to its cancellation on November 1, 1925. The respondent has also failed to allow a deduction on account of the loss sustained by said Artemas Ward, Inc., resulting from the cancellation of said contract on November 1, 1925, of not less than $605,619.30, the unexhausted portion of the March 1, 1913, fair market value or of the cost thereof.

(i) As hereinbefore stated United Brokerage Company, a Delaware corporation, acquired the issued and outstanding capital stock of Artemas Ward, Inc., a New York corporation, on June 30, 1925. The cost of this stock was $3,414,345.63, representing the cash consideration agreed to be paid. On December 31, 1925, the net book value of the assets of said Artemas Ward, Inc., was the sum of $1,246,920.07. On December 31, 1925, pursuant to a plan of reorganization the said Artemas Ward, Inc., transferred all of its assets, subject to liabilities, with the exception of cash and accounts receivable aggregating $284,967.21, to Artemas Ward, Inc., a corporation organized under the laws of the State of Delaware, in exchange for 100 shares of the no par value common stock of that corporation. Immediately after this transfer and on December 31, 1925, Artemas Ward, Inc., a New York corporation, distributed [fol. 16] to its sole stockholder, United Brokerage Company, a Delaware corporation, the 100 shares of the capital stock of Artemas Ward, Inc., a Delaware corporation, and accounts receivable aggregating $234,967.21.

(j) On December 15, 1926, United Brokerage Company, a Delaware corporation, sold 497 shares of the no par common stock of Artemas Ward, Inc., a New York corporation, to George B. Anderson, an individual, for $4,970. Thereafter and on December 24, 1926, said United Brokerage Company sold to said Anderson for $44,670, all the remaining outstanding stock of Artemas Ward, Inc., a New York corporation, consisting of 4,467 shares. The resulting losses from these two transactions were, respectively, $306,601.60 and $2,755,712.94, a total of $3,062,314.54 and have not been allowed as deductions in computing the net income of said United Brokerage Company for the year 1926. The aggregate amount allowed by the respondent on account of these losses is $495,696.76.

(k) During the years 1923 and/or 1924 the corporations hereinafter listed in this paragraph, which have been determined by the respondent to have been affiliated with the petitioner for the year 1925, sustained net losses in respect of which the respondent has failed and refused to allow deductions for the year 1925 in computing the net income of such corporations, the consolidated net income, the total tax of the consolidated group, and the proportion [fol. 17] of such tax to be assessed upon the petitioner. The amount of the net loss of each such corporation for each year is that set opposite the name of the respective corporations.

Name	Year 1923	Year 1924
United Brokerage Company (Del.)	$ ——	$207,799.89
Street Railways Advertising Company (Del.)	——	11,577.84
Street Railways Advertising Company (N. Y.)	55,190.96	27,660.81
Broadway Subway Advertising Co., Inc		175,003.34
Mark D. Batchelder Company	5,495.80	——
*(Motor Coach Advertising Service, Inc. (Md.)		11,934.84
(Bus Advertising Service, Inc. (Md.)	13,220.83	
*(Motor Coach Advertising Service, Inc. (N. Y.)		
(Bus Advertising Service, Inc. (N. Y.)	7,102.65	7,193.09
A. H. Armstrong Company	——	867.42
Iroquois Advertising Company	1,521.96	——
Transit Sales Corporation	13,405.53	3,146.12
Standard Vending Corporation	5,881.28	8,849.95
*(Advertising Samplers, Inc		
(National Vending Service, Inc	26,149.75	17,342.84
Interstate Sales Company	5,508.19	2,721.13
De Soto Paint Manufacturing Company	33,199.51	2,223.22
Quincy Warehouse Company	16,254.12	9,324.34
*(The Florida Railroad and Navigation Corporation	58,800.58	304,425.11
(Florida Hotel and Navigation Company		
Florida Gulf Coast Hotels, Inc	32,126.03	42,396.78
Alexander, Ramsey & Kerr, Inc	——	2,029.79
*(Island Realty Company		2,755.56
(Island Investment Company	650.33	
Deep Lake Company	216,553.75	38,469.57
*(Neighborhood Stores Display Service, Inc		
(Manufacturers Display Service Corp	10,429.84	6,843.29
[fol. 18]		
Universal Vending Service Company	53,711.58	43,392.89
Luna Amusement Company	263,118.48	——
Crazy Village Amusement Corporation	5,894.32	——
Harum Scarum Amusement Corporation	17,406.03	——
Lee County Land Company	1,710.37	7,117.19
Gulf Coast Realties Corporation	207.81	——
Florida Timber Lands Corporation	687.32	4,321.32
The Barfield Company	2,489.84	——
Florida Development Company		26,117.20
Inter County Telephone & Telegraph Company		7,615.04

* Change of name.

(l) All corporations of the affiliated group listed in paragraph (k) above which had losses and net losses for the year 1823 also had losses and net losses for the year 1924 except those listed hereunder in this paragraph, which had net income (computed without deduction for net losses of the year 1923) in the amounts set opposite the names of the respective corporations.

Name	1924 Net Income Computed without Deduction for 1923 Net Loss
Mark D. Batchelder Company	$276.76
Iroquois Advertising Company	795.57
Luna Amusement Company	75,745.14
Crazy Village Amusement Corporation	2,236.80
Harum Scarum Amusement Corporation	8,183.93
Gulf Coast Realties Corporation	17.56
The Barfield Company	601.64

(m) During the years 1924 and/or 1925 the corporations [fol. 19] hereinafter listed in this paragraph, which have been determined by the respondent to have been affiliated with the petitioner for the year 1926, sustained net losses in respect of which the respondent has failed and refused to allow deductions for the year 1926 in computing the net income of such corporations, the consolidated net income, the total tax of the consolidated group, and the proportion of such tax to be assessed upon the petitioner. The amount of the net loss of each such corporation for each year is that set opposite the name of the respective corporations.

Name	Year 1924	Year 1925
United Brokerage Company (Del.)	$207,799.89	$237,982.09
Street Railways Advertising Company (N. Y.)	27,660.81	14,925.62
Broadway Subway Advertising Co., Inc	175,003.34	——
Mark D. Batchelder Company	——	1,294.66
Motor Coach Advertising Service, Inc. (Md.)	11,934.84	37,752.08
(Motor Coach Advertising Service, Inc. (N. Y.)		12.15
*(Bus Advertising Service, Inc. (MD.)	7,193.09	
A. H. Armstrong Company	867.42	1,415.64
Iroquois Advertising Company	——	1,294.30
Transit Sales Corporation	3,146.12	2,405.25
Standard Vending Corporation	8,849.95	8,369.19
*(Advertising Samplers, Inc		25,195.03
(National Vending Service, Inc.	17,342.84	
Interstate Sales Company	2,721.13	1,922.11
Bus Advertising Service, Inc. (Del.)	——	280.83
Quincy Warehouse Company	9,324.34	3,499.48
The Florida Railroad and Navigation Corporation	304,425.11	278,038.98

[fol. 20]

Name	Year 1924	Year 1925
Florida Gulf Coast Hotels, Inc	42,396.78	54,536.64
Island Realty Company	2,755.56	570.29
Deep Lake Company	38,469.57	21,397.04
Advertisers Service Corporation	—	32.87
*(Neighborhood Stores Display Service, Inc		6,330.38
(Manufacturers Display Service Corp	6,843.29	
Northwestern Advertising Company, Inc	—	31,783.35
Universal Vending Service Company	43,392.89	38,216.45
Crazy Village Amusement Corporation	—	7,580.15
Witching Waves Company	—	4,151.49
Harum Scarum Amusement Corporation	—	1,012.96
Lee County Land Company	7,117.19	74,069.56
Gulf Coast Realties Corporation	—	20,932.37
Florida Timber Lands Corporation	4,321.32	78,417.58
The Barfield Company	—	8,864.38
Florida Development Company	26,117.20	21,031.34
John Weiss, Inc., Photographers	—	118.31
Inter County Telephone & Telegraph Company	7,615.04	23,824.79
Everglades Publishing Company	—	2,433.34
Times Square Utilities Company, Inc	—	1,838.57

* Change of name.

(n) All corporations of the affiliated group listed in paragraph (m) above which had losses and net losses for the year 1924 also had losses and net losses for the year 1925 except Broadway Subway Advertising Company which in the year 1925 had net income (computed without deduction for net loss of the year 1924) of $138,451.18.

(o) During the years 1925 and 1926 the corporations [fol. 21] hereinafter listed in this paragraph became liable under the statutes of the State of New York for franchise taxes which have been assessed in the amounts set opposite their respective names and which the respondent has failed to allow as deductions in computing the net income of such corporations, as well as the consolidated net income, the total tax of the consolidated group, and the proportion of such tax to be assessed upon the petitioner.

Name	Year 1925	Year 1926
Barron G. Collier, Inc. (N. Y.)	$47,332.38	$2,803.22
Street Railways Advertising Company (N. Y.)	15.00	15.00
Empire State Advertising Company	155.93	25.00
Motor Coach Advertising Service, Inc	10.00	10.00
Parker, Griesar & Savel, Inc	10.00	56.25
Pacific Railways Advertising Company	10.00	10.00
Manhattan General Equipment Co	500.00	500.00
The Tabard Press	4,220.87	4,204.26
Luna Amusement Company	3,408.53	4,196.03
Crazy Village Amusement Corporation	100.67	10.00
American Ammone Company	1,680.12	1,680.53

Wherefore, the petitioner prays that the Board may hear this proceeding and find and determine as follows:

(a) That Artemas Ward, Inc., a New York corporation, is entitled to a deduction in computing net income for the year 1925 for the exhaustion of the March 1, 1913, fair market value or of the cost of a contract with the Interborough Rapid Transit Company, of not less than $63,749.40.

(b) That Artemas Ward, Inc., a New York corporation, [fol. 22] is entitled to a deduction in computing net income for the year 1925, for a loss sustained by reason of the cancellation of the contract with the Interborough Rapid Transit Company on November 1, 1925, of not less than $605,619.30.

(c) That United Brokerage Company, a Delaware Corporation, is entitled to deductions in computing net income for the year 1926, for losses sustained on sales of the capital stock of Artemas Ward, Inc., a New York corporation, in the aggregate amount of $3,062,314.54 instead of the aggregate amount of $495,696.76, allowed by the respondent.

(d) That in computing net income for the year 1925 of the corporations listed in paragraph 5 (k), deductions be allowed on account of the net losses of such corporations for the years 1923 and/or 1924 as required by the provisions of Section 206 of the Revenue Act of 1926.

(e) That in computing net income for the year 1926 of the corporations listed in paragraph 5 (m), deductions be allowed on account of the net losses of such corporations for the years 1924 and/or 1925 as required by the provisions of Section 206 of the Revenue Act of 1926.

(f) That in computing net income for the years 1925 and 1926 of the corporations listed in paragraph 5 (o), deductions be allowed for New York State franchise taxes accrued during such years in the amounts shown in said paragraph 5 (o).

[fol. 23] (g) Such other and further relief to which the petitioner may be entitled under the Revenue Act of 1926.

(Sgd.) Laurence Graves, Murphy, Lanier and Quinn, 618 Southern Building, Washington, D. C. Of Counsel: G. A. O'Donohue, Murphy, Lanier and Quinn, 522 Fifth Avenue, New York, N. Y. A. M. Kracke, Davis & Kracke, The Rookery, Chicago, Ill., Attorneys for Petitioner.

Duly sworn to by W. A. Buckner. Jurat omitted in printing.

[fol. 24] EXHIBIT "A" TO PETITION

Copy

NP-2-26.

Treasury Department, Washington

Office of Commissioner of Internal Revenue

Address reply to Commissioner of Internal Revenue and refer to Broadway Subway Advertising Company, c/o United Brokerage Company of Delaware, 220 West 42nd Street, New York, New York.

Oct. 21, 1930.

SIRS:

You are advised that the determination of your tax liability for the years 1925 and 1926 discloses a deficiency of $49,606.92, as shown in the statement attached.

In accordance with Section 274 of the Revenue Act of 1926, notice is hereby given of the deficiency mentioned. Within sixty days (not counting Sunday as the sixtieth day) from the date of the mailing of this letter, you may petition the United States Board of Tax Appeals for a redetermination of your tax liability.

However, if you do not desire to petition, you are requested to execute the enclosed agreement form and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P-7. The signing of this agreement will expedite the closing of your returns [fol. 25] by permitting an early assessment of any deficiency and preventing the accumulation of interest charges, since the interest period terminates thirty days after filing the enclosed agreement, or on the date assessment is made, whichever is earlier; whereas if no agreement is filed, interest will accumulate to the date of assessment of the deficiency.

Respectfully, David Burnet, Commissioner, by J. C. Wilmer, Deputy Commissioner.

Enclosures: Statement, Form 882, Form 870.

IT:AR:A-5.
HGF-60D.

Statement of Returns Examined

and

Resulting Tax Liability

Returns Examined

Company.	Year.	Form.
Broadway Subway Advertising Company, c/o United Brokerage Company of Delaware, 220 West 42nd Street, New York, New York.	1925	*
	1926	*

[fol. 26]

Tax Liability

Year.	Corrected tax liability.	Tax previously assessed.	Deficiency.
1925	$7,109.71	None	$7,109.71
1926	42,497.21	None	42,497.21
Totals	$49,606.92	None	$49,606.92

Allocation of this tax to your company is in accordance with the provisions of Section 240 of the Revenue Act of 1926, and is fully explained in a separate communication addressed to the United Brokerage Company of Delaware.

Consents which will expire December 31, 1930, except as extended by the provisions of Section 277(b) of the Revenue Act of 1926, are on file for the years 1925 and 1926.

BEFORE UNITED STATES BOARD OF TAX APPEALS

[Title omitted]

ANSWER—Filed Feb. 10, 1931

The Commissioner of Internal Revenue, by his attorney, C. M. Charest, General Counsel, Bureau of Internal Revenue, for answer to the petition filed in the above-entitled appeal, admits and denies as follows:

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* The income has been reported in the consolidated returns filed by the United Brokerage Company of Delaware, Parent.

[fol. 27] 1, 2 and 3. Admits the allegations in paragraphs 1, 2 and 3.

4. Denies the notice of deficiency is based upon the errors alleged and set forth in paragraphs 4(a to f).

5(a). Admits the allegations contained in paragraph 5(a), except that it is denied that the petitioner was held by the respondent to be affiliated with Ridgways, Incorporated.

5(b). Admits the allegations contained in paragraph 5(b), except that it is denied that Ridgways, Incorporated, was affiliated with the consolidated group of which petitioner is a member.

5(c). Denies the allegations contained in paragraph 5(c).

5(d). Admits the allegations contained in paragraph 5(d), except that it is denied that the March 1, 1913, value of the contract in question was $3,028,096.42.

5(e) Admits the allegations in paragraph 5(e).

5(f) and 5(g). Denies the allegations in paragraphs 5(f) and 5(g).

5(h). Admits the allegations in paragraph 5(h).

5(i) to 5(o). Denies the allegations in paragraphs 5(i) to 5(o) inclusive.

Wherefore, it is prayed that the taxpayer's appeal be denied.

(Signed) C. M. Charest, General Counsel, Bureau of Internal Revenue. Of Counsel: W. Frank Gibbs, Special Atty., Bureau of Int. Revenue.

[fol. 28] BEFORE UNITED STATES BOARD OF TAX APPEALS

[Title omitted]

AMENDMENT TO PETITION

(Excerpt from Transcript of Hearing of Jan. 16, 1933)

Mr. Graves: With respect to the amount of tax—the amount of deduction on the loss of the contract, it seems

to me that is purely a matter of argument. We have claimed $604,000. I hate to amend all of these 35 petitions to make my claim for the larger amount——

Mr. Gibbs: That brings up a question—I have no objection to the procedure, which I think is practiced in presenting cases to the Board, that the pleadings may be considered to conform to the proof which we are now submitting, and if that is agreeable, I have no objection to that procedure.

The Member: If we reach a conclusion that a higher value than $605,000 should be allowed, we can consider that the petitions ask for the higher value?

Mr. Gibbs: Yes.

The Member: Very well.

[fol. 29] BEFORE UNITED STATES BOARD OF TAX APPEALS

[Title omitted]

STIPULATION OF FACTS—Filed Jan. 16, 1933

It is hereby agreed and stipulated by and between the parties to this proceeding through their respective attorneys that the following facts are true, without prejudice to the rights of either party to present further or additional evidence:

1. The petitioner is one of a group of thirty-four affiliated corporations having appeals pending before this Board involving the taxable years 1925 and/or 1926. The names of such corporations and the docket numbers of their respective appeals are as follows:

Name.	Docket No.
Southern Advertising Agency, Inc.	51346
Neighborhood Stores Display Service, Inc.	51347
Artemas Ward, Inc.	51348
Luna Amusement Company	51349
Harum Scarum Amusement Corporation	51350
The Stearn Advertising Company	51351
[fol. 30] Motor Coach Advertising Service, Inc.	51352
Philadelphia Advertising Company	51353
Bluff City Paint Company (formerly DeSoto Paint Manufacturing Company)	51354

Name.	Docket No.
Parker, Griesar & Savel, Inc.	51355
Inland Advertising Agency	51356
Western Advertising Company	51357
Collier Advertising Service, Inc. (formerly Artemas Ward, Inc.)	51358
Barron G. Collier, Incorporated, of Texas	51359
Iroquois Advertising Company	51360
Helter Skelter Slide Corporation	51361
Chicago Elevated Advertising Company	51363
The Tabard Press	51364
Empire State Advertising Company	51365
Oceanview Realty Operating Company, Inc.	51366
The Stearn Advertising Company of New York	51367
Barron G. Collier, Inc.	51368
A. H. Armstrong Company	51369
Mark D. Batchelder Company	51370
Collier Service Corporation (formerly Broadway Subway Advertising Co., Inc.)	51372
Alexander, Ramsey & Kerr, Inc.	51373
Middle States Publicity Company, Inc.	51374
American Ammone Company	51375
Pacific Railways Advertising Company	51376
Street Railways Advertising Company	51377
Manhattan Mercantile Corporation	51378
United Stores Land & Improvement Company	51379
Island Investment Company	51380

2. This stipulation of facts shall serve as a stipulation of [fol. 31] the facts in each of the proceedings listed in the preceding paragraph, which have been or will be consolidated for hearing and decision with this proceeding.

3. The petitioner during the years 1925 and 1926 was one of a group of corporations affiliated, within the meaning of the provisions of Section 240 of the Revenue Act of 1926, with the following corporations, the gross income and deductions of which were reported in a consolidated return for each of said years, filed by United Brokerage Company, a Delaware corporation, as provided in said section:

United Brokerage Company (Del.).
Street Railways Advertising Company (Del.).
The Stearn Advertising Company of New York.
Barron G. Collier, Inc. (N. Y.).

Barron G. Collier, Incorporated, of Texas.
Street Railways Advertising Company (N. Y.).
Broadway Subway Advertising Co., Inc.
Empire State Advertising Company.
Middle States Publicity Company, Inc.
Mark D. Batchelder Company.
Motor Coach Advertising Service, Inc. (Md.).
Motor Coach Advertising Service, Inc. (N. Y.).
Motor Coach Advertising Service, Inc. (Ill.).
A. H. Armstrong Company.
Southern Advertising Agency, Inc.
East St. Louis Car Advertising Co., Inc.
Iroquois Advertising Company.
Western Car Advertising Company.
Transit Sales Corporation.
[fol. 32] Standard Vending Corporation.
Advertising Samplers, Inc.
Interstate Sales Company.
Bus Advertising Service Inc. (Del.).
De Soto Paint Manufacturing Company.
Quincy Warehouse Company.
Parker, Griesar & Savel, Inc.
The Florida Railroad and Navigation Corporation.
Florida Gulf Coast Hotels, Inc.
Alexander, Ramsey & Kerr, Inc.
Island Realty Company.
Deep Lake Company.
Automatic Machine Development Corporation.
Advertisers Service Corporation.
* Listerated Gum Corporation.
** Artemas Ward, Inc. (Del.).
* Artemas Ward, Inc. (N. Y.).
Street Railways Advertising Company (N. J.)
Western Advertising Company.
Barron G. Collier, Incorporated, of Delaware.
Chicago Elevated Advertising Company.
Neighborhood Stores Display Service, Inc.
Inland Advertising Agency.
Northwestern Advertising Company, Inc.

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* Included in the consolidated return of the year 1925 only.

** Included in the consolidated return of the year 1926 only.

Universal Vending Service Company.
Pacific Railways Advertising Company.
The Stearn Advertising Company (Ohio).
Manhattan General Equipment Co.
The Tabard Press.
Luna Amusement Company.
[fol. 33] Crazy Village Amusement Corporation.
Witching Waves Company.
Helter Skelter Slide Corporation.
Harum Scarum Amusement Corporation.
Oceanview Realty Operating Company, Inc.
Lee County Land Company.
Gulf Coast Realties Corporation.
Florida Timber Lands Corporation.
Manhattan Mercantile Corporation.
The Barfield Company.
Island Investment Company.
Florida Development Company.
Philadelphia Advertising Company.
John Weiss, Inc., Photographers.
Inter County Telephone & Telegraph Company.
Everglades Publishing Company.
American Ammone Company.
Times Square Utilities Company, Inc.
United Stores Land & Improvement Company.
**Caloosahatchee Tropical Company.

4. The respondent has determined that the corporations listed in the preceding paragraph were affiliated within the meaning of the Revenue Act of 1926 for the years 1925 and/or 1926 and were permitted to file consolidated returns of net income for such years and has determined the tax liability of such corporations upon the basis of the consolidated returns filed by said United Brokerage Company for such corporations for such years and has determined the proportion of the tax found to be due upon such returns which should be assessed upon each of such corporations.

[fol. 34] 5. Artemas Ward, Inc. (N. Y.), which was affiliated with the petitioner from July 1, 1925 to December

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**Included in the consolidated return of the year 1926 only.

31, 1925, was organized as a corporation under the laws of the State of New York on or about December 30, 1921 and on March 13, 1922, acquired the assets employed by one Artemas Ward in his advertising vending and news selling business, in exchange for the issuance of its entire stock to said Artemas Ward. One of the assets so acquired was a contract with Interborough Rapid Transit Company, a corporation engaged in business in New York City, which granted to said Artemas Ward the advertising, vending and news selling privileges in the cars and stations of the subways and elevated railways of Interborough Rapid Transit Company and affiliated companies. This contract until December 31, 1928.

6. The fair market value of said contract on March 1, 1913, was $3,028,096.42. In the determination of the Federal income tax liability of said Artemas Ward for the years 1913 to 1920, inclusive, the respondent has allowed as deductions in computing net income the following amounts on account of the exhaustion of said March 1, 1913, value of said contract:

1913	$159,373.50
1914	191,248.20
1915	191,248.20
1916	191,248.20
1917	191,248.20
1918	191,248.20
1919	191,248.20
1920	191,248.20

[fol. 35] 7. The gross income and deductions from the advertising, vending and news selling business of said Artemas Ward for the year 1921 and for the period January 1, 1922 to March 13, 1922, were reported in Federal income tax returns filed by said Artemas Ward, Inc., under the provisions of Section 229 of the Revenue Act of 1921. In the determination of the Federal income tax liability of said Artemas Ward, Inc., for the years 1921, 1922, 1923, 1924 and for the period January 1, 1925 to June 30, 1925, the respondent has allowed the following deductions in

computing net income on account of the exhaustion of the value of said contract with Interborough Rapid Transit Company:

1921	$191,248.20
1922	766,642.59
1123	766,642.59
1924	191,248.20
Jan. 1 to June 30, 1925	95,624.10

8. The deduction allowable in the computation of the net income of said Artemas Ward, Inc., for the period January 1, 1922 to March 13, 1922, on account of the exhaustion of the March 1, 1913 value of said contract with Interborough Rapid Transit Company is $37,201.66. The deduction allowable in the computation of the net income of said Artemas Ward, Inc., for the period from March 14, 1922 to December 31, 1922, is the amount of $613,314.07, based upon a value for said contract at the time it was acquired by said Artemas Ward, Inc., in excess of the March 1, 1913 value thereof.

[fol. 36] 9. On June 30, 1925, the issued and outstanding capital stock of said Artemas Ward, Inc., consisting of 4,964 shares of no par value common stock, was acquired by said United Brokerage Company at a cost of $3,414,345.63.

10. The said contract with Interborough Rapid Transit Company was terminated November 1, 1925, by the Transit Commission of the State of New York.

11. In the determination of the net income of said Artemas Ward, Inc., for the period from July 1, 1925 to December 31, 1925, the respondent has failed to allow a deduction on account of the exhaustion of the March 1, 1913, fair market value of said contract with Interborough Rapid Transit Company for the months of July, August, September and October, prior to its cancellation on November 1, 1925. The deduction allowable for the exhaustion of said value for said months is $63,749.40.

12. In the consolidated return filed by said United Brokerage Company for the calendar year 1925 the gross income and deductions of said Artemas Ward, Inc., were reported for the period July 1 to December 31, 1925. A

deduction of $2,427,701.18 was claimed in said return by said Artemas Ward, Inc., as the amount of the loss sustained by it as the result of the cancellation of said contract with Interborough Rapid Transit Company on November 1, 1925.

13. In the determination of net income of said Artemas Ward, Inc., for the period from July 1, 1925 to December [fol. 37] 31, 1925, the respondent has determined that said Artemas Ward, Inc., sustained no deductible loss by reason of the termination of said contract with Interborough Rapid Transit Company.

14. On December 31, 1925, the fair value of the net assets of said Artemas Ward, Inc., was $1,246,920.07. On December 31, 1925, in pursuance of a plan of reorganization, said Artemas Ward, Inc., transfered all of its assets subject to liabilities with the exception of cash and accounts receivable, aggregating $284,967.21, to Artemas Ward, Inc., a corporation organized under the laws of the State of Delaware, in exchange for the issuance to it of 100 shares of the no par value common stock of that corporation, said 100 shares being all of the issued and outstanding capital stock at said time. Immediately after this transfer and on December 31, 1925, Artemas Ward, Inc., a New York corporation, distributed to its sole stockholder, said United Brokerage Company, in pursuance of said plan, said 100 shares of the capital stock of Artemas Ward, Inc., a Delaware corporation, and accounts receivable aggregating $234,967.21, without the surrender by said United Brokerage Company of any of the capital stock of said Artemas Ward, Inc., a New York corporation.

15. On December 15, 1926, said United Brokerage Company sold 497 shares of the no par value common stock of Artemas Ward, Inc., a New York corporation, for $4,970.00 to George B. Anderson, who had no connection with any of the corporations a party to these proceedings either as an officer, employee or stockholder. Thereafter and on [fol. 38] December 24, 1926, said United Brokerage Company sold to said George B. Anderson all of the remaining outstanding capital stock of said Artemas Ward, Inc., a New York corporation, consisting of 4,467 shares for $44,670.00.

16. In the consolidated return filed by said United Brokerage Company for itself and affiliated companies for the year 1925 a deduction of $3,062,314.54 was claimed by said United Brokerage Company as a loss resulting from said sales of the stock of Artemas Ward, Inc., a New York corporation, in December, 1926. The loss so claimed was computed in the following manner: The cost to said United Brokerage Company of the stock of Artemas Ward, Inc., a New York corporation, of $3,414,345.63 was apportioned between the 4,964 shares of the stock of said Artemas Ward, Inc., a New York corporation, and the 100 shares of the stock of said Artemas Ward, Inc., a Delaware corporation, in accordance with the provisions of Article 1599 of Regulations 69 in force and effect at the time of said transactions in December, 1926. In accordance with the apportionment so made, the portion of said cost allocated to said 100 shares of stock of Artemas Ward, Inc., a Delaware corporation, was $67,423.88 and the balance of said cost, namely, $3,346,921.75, was allocated to the 4,964 shares of the stock of Artemas Ward, Inc., a New York corporation.

17. The $3,346,921.75 so apportioned to the 4,964 shares of Artemas Ward, Inc., a New York corporation, was then reduced by $234,967.21, representing the value of the ac- [fol. 39] counts receivable distributed to said United Brokerage Company on December 31, 1925, by Artemas Ward, Inc., a New York corporation, as hereinbefore stated. The cost so apportioned to the 4,964 shares of stock of Artemas Ward, Inc., a New York corporation, was $3,111,954.54, to wit, $826,904621 per share, and when the 497 shares of said stock were sold on December 15, 1926, for $4,970.00 said United Brokerage Company computed its loss through said sale to be the sum of $306,601.60 and when the balance of said stock consisting of 4,467 shares was sold on December 24, 1926, said United Brokerage Company computed its loss through said sale to be $2,755,712.94, the aggregate of such losses being the amount of the $3,062,314.54 which was claimed as a deduction as hereinbefore stated.

18. In the determination of the deficiencies in tax for the year 1926 at issue in these proceedings the respondent has allowed as a deduction on account of the losses sustained by United Brokerage Company upon the sales of said stock

of Artemas Ward, Inc., a New York corporation, in December, 1926, the amount of $495,696.76. Said amount was computed by the respondent in accordance with Treasury Decision 4274, promulgated November 12, 1929, amending Article 1599 of Regulations 69, in the following manner:

Cost of stock of Artemas Ward, Inc. (N. Y.)			$3,414,345.63
Net worth Artemas Ward, Inc. (N. Y.) Dec. 31, 1925 (date of reorganization)			$ 284,967.21
Net worth Artemas Ward, Inc. (Del.) Dec. 31, 1925			961,952.86
Total			$1,246,920.07
[fol. 40]			
Ratio:			
To Artemas Ward, Inc. (N. Y.)			22.85369%
To Artemas Ward, Inc. (Del.)			77.14631%
Total			100.
Basis remaining after reorganization:			
Artemas Ward, Inc. (N. Y.) (3,414,345.63 x 22.85369%)			$ 780,303.97
Artemas Ward, Inc. (Del.) (3,414,345.63 x 77.14631%)			2,634,041.66
Total			$3,414,345.63
Basis Artemas Ward, Inc. (N. Y.)		$780,303.97	
Accounts Receivable and Cash	$284,967.21		
Cash Retained	50,000.00		
Distributed to United Brokerage Company of Delaware	$234,967.21	234,967.21	
Net basis		$545,336.76	
Selling prices—			
497 shares	$4,970.00		
4,467 shares	44,670.00		
		49,640.00	
Loss on sale		$495,696.76	

19. The corporations hereinafter listed in this paragraph are entitled to deductions for the years 1925 and 1926 on account of New York State franchise taxes, which have been assessed against them in the amounts set opposite their respective names, which amounts have not been allowed as deductions by the respondent in the determination of the deficiencies in tax at issue in these proceedings:

[fol. 41]

Name	Year 1925	Year 1926
Barron G. Collier, Inc. (N. Y.)	$47,332.38	$2,803.22
Street Railways Advertising Company (N. Y.)	15.00	15.00
Empire State Advertising Company	155.93	25.00
Motor Coach Advertising Service, Inc	10.00	10.00
Parker, Griesar & Savel, Inc	10.00	56.25
Pacific Railways Advertising Company	10.00	10.00
Manhattan General Equipment Co	500.00	500.00
The Tabard Press	4,220.87	4,204.26
Luna Amusement Company	3,408.53	4,196.03
Crazy Village Amusement Corporation	100.67	10.00
American Ammone Company	1,680.12	1,680.53

(S.) Laurence Graves, 618 Southern Building, Washington, D. C.; (S.) Arthur M. Kracke, The Rookery, Chicago, Illinois, Attorneys for Petitioner. (S.) C. M. Charest, General Counsel, Bureau of Internal Revenue, Attorney for Respondent.

[fol. 42] Before United States Board of Tax Appeals

Docket Nos. 51,345-51,361, 51,363-51,370, 51,372-51,380

Manhattan General Equipment Company et al.[1],
Petitioners,

v.

Commissioner of Internal Revenue, Respondent

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[1]Proceedings of the following petitioners are consolidated and decided herewith: Southern Advertising Agency, Inc.; Neighborhood Stores Display Service, Inc.; Artemas Ward, Inc.; Luna Amusement Co.; Harum Scarum Amusement Corporation; The Stearn Advertising Company; Motor Coach Advertising Service, Inc.; Philadelphia Advertising Company; Bluff City Paint Company (formerly DeSoto Paint Manufacturing Company); Parker, Griesar & Savel, Inc.; Inland Advertising Agency; Western Advertising Company; Collier Advertising Service, Inc. (formerly Artemas Ward, Inc.); Barron G. Collier, Inc., of Texas; Iroquois Advertising Co.; Helter Skelter Slide Corporation; Chicago Elevated Advertising Company; The Tabard Press; Empire State Advertising Company; Oceanview Realty Operating Company, Inc.; The Stearn Advertising Company of New York; Barron G. Collier, Inc.;

Promulgated November 23, 1933

1. A corporation acquired a contract from an individual in an exchange upon which no gain or loss was recognized under the Revenue Act of 1921, and, under the Revenue Act of 1926, the basis for determining gain or loss to the corporation was the same as it would be in the hands of [fol. 43] the transferor. Held, in determining gain or loss resulting from cancellation of the contract prior to the end of its term, the basis should be reduced, not only by the deductions for exhaustion of the contract allowable to the corporation, but also by those allowable to the transferor.

2. Where a stockholder receives shares of stock in another corporation, pursuant to a plan of reorganization, without surrender of its original shares, and thereafter sells the original shares, the gain or loss on the shares sold should be computed by allocating the basis of the shares originally held between those shares and the shares acquired in the reorganization, in proportion to the value of each stock at the date of reorganization, rather than in proportion to the number of shares of each stock held at that time. Bertha G. Bamberger, 27 B. T. A. 785, followed.

Laurence Graves, Esq., and A. M. Kracke, Esq., for the Petitioners.

W. Frank Gibbs, Esq., for the Respondent.

OPINION

MURDOCK:

The taxes in controversy are income taxes for the years 1925 and 1926. The proceedings have been consolidated. The parties filed a stipulation of facts in which the affiliated status of the various petitioners and other pertinent facts

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A. H. Armstrong Company; Mark D. Batchelder Company; Collier Service Corporation (formerly Broadway Subway Advertising Co., Inc.); Alexander, Ramsey & Kerr, Inc.; Middle States Publicity Company, Inc.; American Ammone Company; Pacific Railways Advertising Company; Street Railways Advertising Company; Manhattan Mercantile Corporation; United Stores Land & Improvement Company; Island Investment Company.

are shown. There was no testimony or other evidence except a copy of a notice of deficiency.

[fol. 44] The only issue in so far as the year 1925 is concerned, is whether or not the basis for gain or loss to Artemas Ward, Inc., a corporation of New York, upon the cancellation of a certain contract, should be reduced by deductions for depreciation or exhaustion of the contract allowable to Artemas Ward, an individual, during the period of his ownership of the contract. The contract in question was between the Interborough Rapid Transit Co., a corporation engaged in business in New York City, and Artemas Ward, an individual whereby the former granted to the latter exclusive advertising, vending, and news-selling privileges in the cars and stations of the Transit Co. and its affiliated companies. The contract provided that it should continue until December 31, 1928. It was acquired by Artemas Ward prior to March 1, 1913, and the parties have stipulated that its fair market value on March 1, 1913, was $3,028,096.42.

Artemas Ward, Inc., one of the petitioners herein, was organized under the laws of the State of New York on or about December 30, 1921. On March 13, 1922, Artemas Ward transferred the contract in question to his corporation in exchange for all of its stock. The Transit Commission of the State of New York terminated the contract on November 1, 1925. The parties agree that the transaction whereby Artemas Ward transferred the contract to Artemas Ward, Inc., was one in which no gain or loss was recognized (section 202 [c] of the Revenue Act of 1921), and, therefore, the basis for gain or loss to the corporation on this contract, under the applicable provisions of the Revenue Act of 1926, is the same as the basis would be if [fol. 45] the contract had remained in the hands of Artemas Ward. See section 204 of the Revenue Act of 1926. They also agree that this basis is the fair market value of the contract on March 1, 1913, to wit, $3,028,096.42. Furthermore, there is no difference between the parties as to the amount of the deductions allowable under the various revenue acts to Artemas Ward, the individual, and to Artemas Ward, Inc.

The Commissioner has actually allowed deductions on account of the exhaustion of this contract in excess of the amount allowable. The petitioners concede that total deductions on account of the exhaustion of this contract,

equal to the fair market value of the contract on March 1, 1913, have been properly allowed for periods prior to January 1, 1925. This rather unusual situation, where the entire basis has been deducted prior to the actual exhaustion of the contract, is explained by the fact that for a part of the year 1922, and for all of the year 1923, deductions were allowed to the corporation based upon the cost of the contract to the corporation, as provided by the Revenue Act of 1921. The corporation issued its stock for the contract. The value of the stock was the same as the value of the contract. At that time the contract was apparently much more valuable than it was on March 1, 1913, and for each of those two periods the deduction allowed and allowable far exceeded the annual deduction allowed for other years under the other revenue acts which provided that the basis for depreciation was the March 1, 1913, value.

The corporation claims that it sustained a deductible loss in 1925 on account of the termination of the contract, and [fol. 46] it now contends that this loss is measured by the difference between the March 1, 1913, value of the contract and $1,730,578.36, the deductions for exhaustion of the contract allowable to Artemas Ward, Inc. The Commissioner has allowed no loss. He contends that the basis of the March 1, 1913, value should be reduced, not only by the deductions for exhaustion of the contract allowance to Artemas Ward, Inc., but also by the deductions for exhaustion of the contract allowable to Artemas Ward, the individual. Thus reduced, the basis disappears and there is nothing left to be deducted as a loss. This is the sole difference between the parties which we are asked to consider for the year 1925.

Congress has permitted deductions to be taken for losses under certain circumstances. But one claiming such a deduction must have sustained a loss (Cf. United States v. Flannery, 268 U. S. 98), and must be able to point to some specific provision allowing the deduction. The Revenue Act of 1926, which is applicable to the calendar year 1925, provides in section 202 that the loss shall be the excess of the basis over the amount realized after the basis has been "diminished by the amount of the deductions for exhaustion, wear and tear, obsolescence, amortization, and depletion which have since the acquisition of the property been allowable in respect of such property under this Act or prior income tax laws * * *." Section 202 (b) (2).

The contract in question was apparently canceled without any recourse on the part of the corporation. The petitioners argue that the words "since the acquisition of the property" mean since the acquisition of the property by [fol. 47] the one claiming the loss. Thus they would not diminish the basis by the deductions for exhaustion which were allowable in respect of the property during the time that it was owned by Artemas Ward. The respondent contends that the diminution of the basis is not so limited. The case of Barnett Anchor Oil Co., 25 B. T. A. 746, relied upon by the petitioners, is not in point. There may be room for argument that this particular provision of the statute is not entirely clear, but we think that the intention of Congress is clear when the various provisions of the statute relating to this subject are considered together.

Normally, under the income tax acts gain or loss from an exchange of property for stock is recognized, the property in the hands of the new owner has a new basis for gain or loss, and deductions for exhaustion of the property are computed upon that same basis. The new basis is cost to the new owner. The present question would not arise were it not for exceptions to these general rules. Congress made an exception where an owner of property transferred it to a corporation for stock of that corporation and immediately after the transfer controlled the corporation. It said that under such circumstances no gain or loss to the transferor would be recognized. But it did not stop there. It made other special provisions so that neither the Government nor the taxpayers would be hurt as a result of the nonrecognition of gain or loss. These provisions in effect put the transferee in the transferor's place for tax purposes in so far as that particular property was concerned. Congress provided that the old basis for gain or loss on [fol. 48] the property should persist and apply to the property in the hands of the new owner. It also provided, in acts after the 1921 Act, that depreciation should be computed upon this same basis. The relationship between the old owner and the new was close and it was because of that fact that no gain or loss was recognized upon the transfer. The provisions protected both the Government and the taxpayers. The combination of transferor and transferee was to have neither greater nor less tax benefit from the exhaustion in use or from the disposition of the property than the return through tax free income of the transferor's basis.

If the petitioners' contention were correct, the Government would be the loser in every case through a duplication of deductions on the same asset. There would be no point in using the March 1, 1913, value as the basis for gain or loss and reducing it by less than the entire amount recovered through deductions for depreciation since March 1, 1913.

The Supreme Court of the United States has said that "the amount of the allowance for depreciation is the sum which would be set aside for the taxable year, in order that, at the end of the useful life of the plant in the business, the aggregate of sums set aside will (with the salvage value) suffice to provide an amount equal to the original cost." United States v. Ludey, 274 U. S. 295. The whole purpose of the deductions for depreciation and of the offset against the amount realized upon disposition of an asset, is to provide, from untaxed income, an amount equal to the basis. Where the basis has once been recovered through [fol. 49] such annual deductions, there is no portion of the basis left with which to offset the amount realized from the disposition of the property. If anything is recovered from the disposition of the property or from the use of the property over and above the basis, that amount is income. Likewise, where there has been a full recovery through annual deductions for exhaustion, there can be no loss thereafter if the property is taken away from the owner or its usefulness is otherwise terminated. The above statements are certainly true when applied to property continuously owned by the same taxpayer. Graves, Cox & Co., 27 B. T. A. 546; Elliott-Granite Linen Corp., 26 B. T. A. 936; Proximity Mfg. Co., 18 B. T. A. 691, 698, 699; Gardner Printing Co., 4 B .T. A. 37; Even Realty Co., 1 B. T. A. 355. In our opinion Congress intended to provide and did provide in the Revenue Act of 1926, where an asset is transferred by an individual to a corporation for the stock of the latter, and no gain or loss is recognized, that the two combined are entitled to offset against income the total basis of the transferor and no more. Any further allowance would result in a duplication of deductions for the same capital asset, and any less would not permit the taxpayer to recover the full basis tax free. The petitioners are not entitled to any deduction for 1925 representing loss upon the cancellation of this contract, for there was no loss based

upon March 1, 1913, value. Cf. United States v. Flannery, supra.

The only issue touching the year 1926 relates to the method of computation of gain to the United Brokerage Co. upon the sale by it of the capital stock of Artemas [fol. 50] Ward, Inc., a New York corporation. On June 30, 1925, the United Brokerage Co., of the affiliated group which is before us, acquired all of the outstanding capital stock of Artemas Ward, Inc., consisting of 4,964 shares of no par value common stock, at a cost of $3,414,345.63. On December 31, 1925, Artemas Ward, Inc., pursuant to a plan of reorganization, transferred all of its assets, except cash and accounts receivable aggregating $284,967.21, subject to all of its liabilities, to another corporation of the same name, organized under the laws of the State of Delaware, in exchange for all of the latter's stock, consisting of 100 shares of no par value common. The net value of the assets of the New York corporation on December 31, 1925, was $1,246,920.07. On the same day, but after the transfer, the New York corporation, pursuant to the plan of reorganization, distributed the 100 shares of stock in the Delaware corporation and accounts receivable aggregating $234,967.21 to its sole stockholder, the United Brokerage Co., without the surrender by the latter of its stock in the New York corporation. After this transfer, the New York corporation had no liabilities and its only asset was $50,000 in cash. In December, 1926, the United Brokerage Co. sold all of the stock of Artemas Ward, Inc., the New York corporation, 4,964 shares, to an outside party for a total consideration of $49,640. The United Brokerage Co. filed a consolidated return for 1926 in which it claimed a deduction of $3,062,314.54 as a loss resulting from the sale of the stock of the New York corporation. In computing this loss it apportioned the original cost of the stock of the New York corporation between 4,964 shares of the stock [fol. 51] of the New York corporation and 100 shares of the stock of the Delaware corporation in proportion to the number of shares of each which it held. It thus allocated to the 100 shares of stock of the Delaware corporation $67,423.88 as a basis for gain or loss and it allocated to the 4,964 shares of the stock of the New York corporation $3,346,921.75 as a basis for gain or loss. It then reduced

the basis attributable to the shares of the New York corporation by $234,967.21, representing the value of accounts receivable of that corporation distributed to the United Brokerage Co. in December, 1925. The Commissioner, in determining the deficiencies for 1926, has allowed a loss of $495,696.76, which he computed in accordance with Treasury Decision 4274, which was promulgated on November 13, 1929, to amend article 1599 of Regulations 69, C. B. VIII-2, p. 240. The difference between his method of computation and that used by the taxpayer is that the respondent divided the original cost of the 4,964 shares of stock in the New York corporation between that stock and the stock of the Delaware corporation in proportion to the value of each stock at the date of reorganization and distribution, December 31, 1925. In this way he determined that the basis for gain or loss on the 4,964 shares of stock of the New York corporation was $780,303.97. He reduced this basis by $234,967.21, the value of the accounts receivable distributed to the United Brokerage Co., and then subtracted the total sale price of the shares, to wit, $49,640, which gave a loss on the sale of $495,696.76.

Although this case arises under an earlier revenue act and an earlier regulation is relied upon by the petitioners [fol. 52] than was the case in Bertha G. Bamberger, 27 B. T. A. 785, nevertheless the question here is the same as that decided by the Board in the Bamberger case. The petitioners apparently contend that the loss as computed on the consolidated return was in accordance with paragraph 1 of article 1599 of Regulations 69 as originally promulgated. It is to be regretted that such a regulation was published and allowed to stand for so many years, but, if the petitioner's contention is correct, the case demonstrates the unreasonableness of that regulation. All of the assets of the New York corporation were taken from it with the exception of $50,000 in cash, so that the 4,964 shares were backed by nothing more than $50,000 in cash. The 100 shares of Delaware corporation stock were backed by practically all of the remaining assets which had formerly belonged to the New York corporation. The net value of these assets was almost a million dollars, yet, under the petitioner's method, $3,111,954.54 of the original basis would be attributed to the New York stock and only $67,423.88 of the basis would be allocated to the Delaware

stock. Following our decision in the Bamberger case, we hold for the respondent on this point.

Decision will be entered under Rule 50.

(Seal.)

[fol. 53] BEFORE UNITED STATES BOARD OF TAX APPEALS.

Docket No. 51,372.

COLLIER SERVICE CORPORATION, Formerly Broadway Subway Advertising Company, Inc., Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

DECISION

Pursuant to the Board's opinion promulgated November 23, 1933, the parties on March 15, 1934, filed a stipulation of tax liability under Rule 50. Therefore, it is

Ordered and Decided that there are deficiencies for the years 1925 and 1926 in the amounts of $6,396.22 and $42,344.51, respectively.

(Signed) J. E. Murdock, Member, United States Board of Tax Appeals.

Enter:

Entered Mar. 20, 1934.

[fol. 54] BEFORE UNITED STATES BOARD OF TAX APPEALS

[Title omitted]

PETITION FOR REVIEW—Filed June 20, 1934

Comes now the petitioner, Collier Service Corporation, formerly Broadway Subway Advertising Co., Inc., by its attorneys, Laurence Graves and Arthur M. Kracke, and respectfully shows:

I

Jurisdiction

Your petitioner on review is a corporation organized under the laws of the State of New York, with principal place of business at 220 West 42nd Street, New York, New York. Your respondent on review is the duly appointed, qualified and acting Commissioner of Internal Revenue of the United States.

The petitioner's gross income and deductions for the years in question were included in consolidated returns for Federal income tax purposes filed by United Brokerage Company, a corporation, with the Collector of Internal Revenue for the Third District of New York, whose office [fol. 55] is located in the City of New York and within the judicial circuit of the United States Circuit Court of Appeals for the Second Circuit.

II

Previous Proceedings

The respondent determined that there were deficiencies in Federal income taxes for the calendar years 1925 and 1926, computed on the basis of the consolidated returns filed by United Brokerage Company and its affiliated corporations for those years. The respondent determined that the amounts of such deficiencies that should be apportioned to and assessed against the petitioner were $7,109.71 for the calendar year 1925 and $42,497.21 for the calendar year 1926 and, in accordance with the provisions of Section 274 of the Revenue Act of 1926, sent to the petitioner by registered mail a notice of said deficiencies. Thereafter the petitioner duly filed an appeal from said notice of deficiency with the United States Board of Tax Appeals, said appeal being assigned Docket No. 51,372.

Thereafter a hearing was held by said Board of Tax Appeals. On November 23, 1933, the Board of Tax Appeals promulgated its opinion and on March 20, 1934, said Board of Tax Appeals entered its final order and decision in said appeal, wherein and whereby the Board of Tax Appeals ordered and decided that there was a deficiency in tax for the calendar year 1925 of $6,396.22 and a deficiency for the calendar year 1926 of $42,344.51.

The opinion of the Board of Tax Appeals is published in 29 B. T. A. 395.

[fol. 56] III

Nature of Controversy

The nature of the controversy is as follows:

For the year 1925 the respondent determined that a loss claimed to have been sustained by Artemas Ward, Inc., a New York corporation, one of the corporations affiliated with the petitioner during that year, should be disallowed. The petitioner claimed that the amount of such loss was not less than $605,619.30. The effect of the disallowance of this loss was to increase the tax liability of the consolidated group and the amount of such liability to be apportioned to the petitioner.

For the year 1926 the respondent determined that a loss of $3,062,314.54 claimed by United Brokerage Company, one of the corporations affiliated with the petitioner for that year, should be allowed in the amount of $495,696.76 and the balance of the amount claimed disallowed. The effect of the disallowance of this loss was to increase the tax liability of the consolidated group and the amount of such liability to be apportioned to the petitioner.

Issue for 1925

During the calendar year 1925 the petitioner was affiliated with 66 corporations, the gross incomes and deductions of which were included in a consolidated return filed by the parent or principal corporation, United Brokerage Company, a Delaware corporation.

[fol. 57] The loss of not less than $605,619.30 claimed by Artemas Ward, Inc., a New York corporation, for the calendar year 1925 was one claimed to have been sustained by that corporation by reason of the cancellation on November 1, 1925, by the Transit Commission of the State of New York, of a contract with Interborough Rapid Transit Company.

Artemas Ward, Inc., was organized as a corporation under the laws of the State of New York prior to March 13, 1922, and acquired on that date the assets of one Artemas Ward, an individual, used by him in the conduct of an advertising, vending and news-selling business, including a

contract with Interborough Rapid Transit Company for the advertising, vending and news-selling privileges within the cars and stations of the subways and elevated railways of that company and affiliated companies. This contract had been acquired by said Artemas Ward prior to March 1, 1913, and the respondent stipulated that this contract had a fair market value on March 1, 1913, of $3,028,096.42. The contract with Interborough Rapid Transit Company so acquired by said Artemas Ward, Inc., would by its terms have expired on December 31, 1928.

In the determination of the Federal income tax liability of said Artemas Ward for the years 1913 to 1921, inclusive, the respondent allowed as deductions in computing net income on account of exhaustion of said fair market value $159,373.50 for 1913 and $191,248.20 for each of the other such years. In the determination of the Federal income tax liability of said Artemas Ward, Inc., for each of the years 1922 and 1923 the respondent allowed a deduction for [fol. 58] the exhaustion of such contract, upon the basis of an increased valuation, in the amount of $766,642.59. The respondent has allowed deductions to said Artemas Ward, Inc., for the exhaustion of said contract for the year 1924 in the amount of $191,248.20 and for the period January 1, 1925 to June 30, 1925, in the amount of $95,624.10. The parties have stipulated that the deduction allowable on account of the exhaustion of said contract for the period July 1, 1925 to October 31, 1925 was $63,749.40.

The loss of not less than $605,619.30 claimed by the petitioner in its petition was arrived at by subtracting from the March 1, 1913, value of $3,028,096.42 deductions for the annual exhaustion thereof since March 1, 1913 to November 1, 1925, at the rate of $191,248.20 per annum. On November 1, 1925, the portion of said March 1, 1913, value remaining after such deductions for exhaustion was $605,619.30.

The respondent in his determination reduced the March 1, 1913, value of said contract of $3,028,096.42 by the deductions allowed by him for the exhaustion of said contract since March 1, 1913, to Artemas Ward, the individual, in the amount of $1,689,359.10 as well as to said Artemas Ward, Inc., a New York corporation, in the amount of $1,883,906.88, and he found that the March 1, 1913, value had been entirely exhausted and, accordingly, disallowed the loss claimed to have been sustained.

It was contended by the petitioner at the hearing before the Board of Tax Appeals and in its brief to that Board that said March 1, 1913, value of said contract of $3,028,096.42 should be reduced only by the aggregate of the [fol. 59] deductions for exhaustion in respect thereof to which said Artemas Ward, Inc., was entitled after said contract was acquired by it, the aggregate of said deductions being $1,730,578.36, and that the loss sustained by reason of the cancellation of said contract on November 1, 1925, was the amount of $1,297,518.06. The Board of Tax Appeals approved the action of the respondent in disallowing the loss originally claimed and found that the petitioner had sustained no deductible loss by reason of the cancellation of said contract.

Issue for 1926

For the calendar year 1926 the petitioner was affiliated with 66 corporations, the gross incomes and deductions of which were included in a consolidated return filed by United Brokerage Company, a Delaware corporation.

On June 30, 1925, United Brokerage Company, a Delaware corporation, affiliated with the petitioner for both years in controversy, acquired the entire issued and outstanding capital stock of Artemas Ward, Inc., a New York corporation, consisting of 4,964 shares of no par value common stock, at a cost of $3,414,345.63. As hereinbefore stated, the principal asset of said Artemas Ward, Inc., was a certain contract with Interborough Rapid Transit Company, which was cancelled on November 1, 1925. On December 31, 1925, the net book value of the assets of said Artemas Ward, Inc., was the sum of $1,246,920.07. On December 31, 1925, pursuant to a plan of reorganization, said Artemas Ward, Inc., a New York corporation, transferred all of its assets subject to liabilities, with the ex- [fol. 60] ception of cash and accounts receivable aggregating $284,967.21, to Artemas Ward, Inc., a corporation organized under the laws of the State of Delaware, in exchange for the issuance to it of 100 shares of no par value common stock, representing all of the capital stock of that company issued and outstanding at that time. Immediately after this transfer and on December 31, 1925, said Artemas Ward, Inc., a New York corporation, distributed to its sole stockholder, said United Brokerage Company, in pursuance

of said plan, said 100 shares of the capital stock of Artemas Ward, Inc., a Delaware corporation, and accounts receivable aggregating $234,967.21, without the surrender by said United Brokerage Company of any of the capital stock of said Artemas Ward, Inc., a New York corporation.

On December 15, 1926, said United Brokerage Company sold 497 shares of the no par value common stock of Artemas Ward, Inc., a New York corporation, for $4,970.00. Thereafter and on December 24, 1926, said United Brokerage Company sold all of the remaining outstanding capital stock of said Artemas Ward, Inc., a New York corporation, consisting of 4,467 shares for $44,670.00.

In the consolidated return filed by said United Brokerage Company for itself and affiliated companies for the year 1926, a deduction of $3,062,314.54 was claimed by said United Brokerage Company as a loss resulting from said sales of stock of Artemas Ward, Inc., a New York corporation, in December, 1926. This loss was computed in accordance with the provisions of Paragraph (1) of Article 1599 of Regulations 69, in force and effect at the time of [fol. 61] said transactions in 1925 and 1926. This subdivision provided that the basis of each share of old and new stock would be the quotient of the basis of the old stock divided by the total number of old and new shares.

Thereafter and on November 13, 1929, the respondent revised said Article 1599 of Regulations 69 and provided that where the new stock was stock of a corporation other than the distributing corporation, the basis of the old stock should be apportioned between the old stock and the new stock in proportion to their respective values at the time of such distribution. Under the regulation as so amended he determined that the loss allowable on account of the sales of said stock of Artemas Ward, Inc., a New York corporation, was the amount of $495,696.76. In the proceedings before the Board of Tax Appeals it was contended by the petitioner that the loss sustained as a result of the sale of stock of Artemas Ward, Inc., a New York corporation, should be determined in accordance with the provisions of Article 1599 of Regulations 69 as originally promulgated. The Board of Tax Appeals held that the loss should be computed under the provisions of Article 1599 of Regulations 69 as revised on November 13, 1929, and sustained the action of the respondent in determining that the loss

realized from the sale of said stock of Artemas Ward, Inc., a New York corporation, was $495,696.76.

IV

Assignments of Error

Petitioner believes and avers that errors were committed [fol. 62] by the Board of Tax Appeals to its damage and prejudice and assigns the following errors:

Errors Affecting the Year 1925.

(1) The Board erred in holding that in determining the amount of loss sustained by Artemas Ward, Inc., a New York corporation, by reason of the cancellation of its contract with Interborough Rapid Transit Company, the basis of said contract, namely, the March 1, 1913, value of $3,028,096.41, should be reduced by deductions for exhaustion in excess of those which would have been allowable to Artemas Ward, an individual, if he had held said contract until the date of its cancellation, November 1, 1925.

(2) The Board erred in holding that in determining the amount of loss sustained by Artemas Ward, Inc., a New York corporation, by reason of the cancellation of its contract with Interborough Rapid Transit Company the basis of said contract, namely, the March 1, 1913, value of $3,028,096.42, should be reduced not only by the deductions for the exhaustion thereof allowed to said Artemas Ward, Inc., a New York corporation, but also by the deductions allowed to the transferor of said corporation, namely, Artemas Ward, an individual.

(3) The Board erred in holding that no loss was sustained by said Artemas Ward, Inc., a New York corporation, by reason of the cancellation of its contract with Interborough Rapid Transit Company on November 1, 1925.

[fol. 63] (4) The Board erred in holding that there was a deficiency in tax for the year 1925 in the amount of $6,396.22.

Errors Affecting the Year 1926

(1) The Board erred in holding that the loss sustained by United Brokerage Company in 1926 upon the sale of the

stock of Artemas Ward, Inc., a New York corporation, should be computed in accordance with the provisions of Article 1599 of Regulations 69, as amended and revised on November 13, 1929.

(2) The Board erred in failing to hold that the provisions of Article 1599 of Regulations 69, promulgated August 28, 1926, were legislative in character, and therefore could not be changed by the Commissioner of Internal Revenue, with or without the approval of the Secretary of the Treasury.

(3) The Board erred in failing to hold that the provisions of Article 1599 of Regulations 69, promulgated August 28, 1926, were legislative in character, and that to permit the retroactive amendment of such provisions at any time would be unjust, arbitrary, confiscatory, and violative of the Fifth Amendment to the Constitution.

(4) The Board erred in failing to hold that the provisions of Article 1599 of Regulations 69, promulgated August 28, 1926, were legislative in character, and that to permit the retroactive amendment of such provisions on November 13, 1929, after the expiration of the time within which such provisions might reasonably be changed, would be unjust, arbitrary, confiscatory and violative of the Fifth Amendment to the Constitution.

[fol. 64] (5) The Board erred in failing to hold that even though the provisions of Article 1599 of Regulations 69, promulgated August 28, 1926, are to be considered administrative or interpretive rather than legislative, the provisions of said article could not legally be changed after the reenactment of Section 204(a)(9) of the Revenue Act of 1926 in successive revenue acts.

(6) The Board erred in failing to hold that the loss sustained by United Brokerage Company in 1926 upon the sale of the stock of Artemas Ward, Inc., a New York corporation, should be computed in accordance with the provisions of sub-paragraph (1) of Article 1599 of Regulations 69, as promulgated on August 28, 1926.

(7) The Board erred in failing to hold that if such loss should not be computed in accordance with the provisions of sub-paragraph (1) of Article 1599 of Regulations 69, as

promulgated on August 28, 1926, it should be computed in accordance with the provisions of sub-paragraph (2) of such article as so promulgated.

(8) The Board erred in failing to hold that if such loss should not be computed in accordance with the provisions of either sub-paragraph (1) or sub-paragraph (2) of Article 1599 of Regulations 69, as promulgated August 28, 1926, it should be computed in accordance with the provisions of Section 201(d) of the Revenue Act of 1926.

(9) The Board erred in holding that there was a deficiency in tax for the year 1926 in the amount of $42,344.51.

[fol. 65] Wherefore, the petitioner asks that the decision of the Board of Tax Appeals be reviewed by the United States Circuit Court of Appeals for the Second Circuit; that a transcript of the record be prepared in accordance with law and with the rules of said Court and transmitted to the clerk of said Court for filing, and that appropriate action be taken to the end that the errors complained of may be reviewed and corrected by said Court.

(Signed) Laurence Graves, 295 Madison Avenue, New York, N. Y. (Sgd.) Arthur M. Kracke, The Rookery, Chicago, Illinois, Counsel for Petitioner.

Duly sworn to by Laurence Graves. Jurat omitted in printing.

[fol. 66] BEFORE UNITED STATES BOARD OF TAX APPEALS

[Title omitted]

PRÆCIPE FOR TRANSCRIPT OF RECORD—Filed Aug. 7, 1934

To the Clerk of the United States Board of Tax Appeals:

You are requested to prepare and certify and transmit to the Clerk of the United States Circuit Court of Appeals for the Second Circuit, with reference to the petition for review heretofore filed by the petitioner in the above cause, a transcript of the record in the above cause, prepared and transmitted as required by law and by the rules of said court, and to include in said transcript of record the following documents or certified copies thereof, to wit:

1. The docket entries of all proceedings before the Board of Tax Appeals.
2. The pleadings before the Board.
3. The stipulation of facts.
[fol. 67] 4. Opinion of the Board of Tax Appeals.
5. The decision of the Board.
6. The petition for review.
7. This præcipe.

Laurence Graves, Attorney for Petitioner, 618 Southern Building, Washington, D. C.

Personal service of the foregoing præcipe is hereby acknowledged this 7th day of August, 1934.

Robert H. Jackson, Assistant General Counsel for the Bureau of Internal Revenue, Attorney for Respondent.

[fol. 68] Clerk's Certificate to foregoing transcript omitted in printing.

[fol. 69] UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

MANHATTAN GENERAL EQUIPMENT CO., Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE, Respondent

SECOND CIRCUIT

COLLIER SERVICE CORPORATION, Formerly SUBWAY ADVERTISING CO., INC., Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE, Respondent

Before: Manton, Augustus N. Hand and Chase, Circuit Judges

Petitions for review of decisions of the United States Board of Tax Appeals.

From orders of the Board of Tax Appeals deciding that there were income tax deficiencies of the Manhattan General Equipment Company for the years 1925 and 1926 in the amounts of $485.02 and $299.94, respectively, and of Collier Service Corporation for the years 1925 and 1926 in the amounts of $6,396.22 and $42,344.51 respectively. Affirmed.

The petitioners are affiliates of United Brokerage Company. That corporation filed income tax returns for itself and [fol. 70] its affiliates for 1925 and 1926 and the petitioners seek to review tax deficiencies attributed to them by the Commissioner, which the Board of Tax Appeals has affirmed. For a number of years prior to March 1, 1913, Artemas Ward owned a contract, controlling advertising, vending and news selling privileges within cars and stations of the subways and elevated railways of the Interborough Rapid Transit Company in New York City, which the Commissioner of Internal Revenue determined had a value of $3,028,096.42 on that date. The contract by its terms was to continue in existence until December 31, 1928.

On March 13, 1922, Artemas Ward transferred his contract with the Interborough Rapid Transit Company to

Artemas Ward, Inc., a New York corporation, in exchange for all of its stock. On June 30, 1925, the United Brokerage Company purchased for $3,414,345.63 in cash all the capital stock of Artemas Ward, Inc., that was issued and outstanding consisting of 4,964 shares of no par value. On November 1, 1925, the New York Transit Commission cancelled the Interborough contract.

In assessing the income taxes for the year 1925 for United Brokerage Company and in order to ascertain whether there was any loss during that year caused by the cancellation of the contract, the Commissioner of Internal Revenue allowed as deductions on account of the exhaustion of the March 1, 1913 value of the contract between that date and March 13, 1922, when Artemas Ward assigned it to Artemas Ward, Inc., (New York) the sum of $1,726,560.76 and allowed as deductions between March 13, 1922, and November 1, 1925, when it was cancelled by the Transit Commission, the sum [fol. 71] of $1,730,578.36. If both sums be allowed, the United Brokerage Company has suffered no loss from the cancellation of the contract for they exceed $3,028,096.42, the March 1, 1913, value which was the base. The United Brokerage Company filed a return for the year 1925 for itself, the petitioners and other affiliates. It claims as a loss due to the cancellation of the contract the difference between the base of $3,028,096.42 and the sum of $1,730,578.38 allowed for exhaustion between the date of acquisition on March 13, 1922 and the date of cancellation on November 1, 1925, or $1,297,518.06. The question whether this sum should be allowed as a loss is the first point raised on these appeals.

On December 31, 1925, pursuant to a plan of reorganization, Artemas Ward, Inc. (N. Y.) transferred to Artemas Ward, Inc. (a Delaware corporation), in exchange for 100 shares of stock of the latter company of no par value, all its assets, then of a net book value of $1,246,920.07, with the exception of cash and accounts receivable aggregating $284,967.21—that is to say, the New York corporation transferred to the Delaware corporation assets of the value of $961,952.86. Immediately after the transfer, and on December 31, 1925, Artemas Ward, Inc. (N. Y.) distributed to United Brokerage Company the 100 shares of stock of Artemas Ward, Inc. (Del.) and accounts receivable amounting to $234,967.21. In December, 1926, United Brokerage

sold the entire 4,964 shares of Artemas Ward, Inc. (N. Y.) for $49,640. That stock had cost the United Brokerage $3,414,345.63 and the total must be apportioned between the 100 shares of the Delaware corporation (which it still owns) and the 4,964 shares of Artemas Ward, Inc. (N. Y.) in [fol. 72] order to determine the loss suffered by the United Brokerage Company through its sale of the 4,964 shares at $49,640. The Commissioner fixed the base value of the stock of the New York corporation after the reorganization, pursuant to Article 1599 (2) of Treasury Regulations 69 promulgated August 28 ,1926, as amended November 13, 1929. Article 1599 (2) (as amended) provided that:
"the cost or other basis of the stock in respect of which the distribution is made shall be apportioned between such stock and the stock or securities distributed in proportion, as nearly as may be, to the respective values of each class of stock or security, old or new, at the time of such distribution, * * *"

Upon the reorganization, the New York corporation had left among its assets, valued at $1,246,920.07, accounts receivable and cash aggregating $284,967.21, or approximately 22.85% thereof, after $961,952.86 had been transferred to the Delaware Company. Under Art. 1599 (2) supra, the portion of $3,414,345.63 paid by the United Brokerage Company for the stock of Artemas Ward, Inc. (N. Y.) represented by that stock after the reorganization was $780,303.97. If from this be deducted $234,967.21 accounts receivable and the $49,640 realized from the sale in December, 1926, there would be a loss of $495,696.76. This loss the Commissioner allowed in assessing the income tax for 1925. The second point raised on this appeal is whether the loss, for the year 1926, to which the United Brokerage Company and its affiliates were entitled was only the sum of $495,696.76 or was the sum of $2,167,785.56 which would arise through deducting from $3,414,345.63, (the cost of the stock of the New York company) the value [fol. 73] at the time of the reorganization of the Delaware stock which was $961,952.86 and $234,967.21 realized from accounts receivable and $49,640 realized from sale of the 4964 shares.

Laurence Graves and A. M. Kracke, Attorneys for petitioners, Caruthers Ewing, Counsel.

Frank J. Wideman, Assistant Attorney General for respondent; Sewall Key and Helen R. Carloss, Special Assistants to the Attorney General, Counsel.

AUGUSTUS N. HAND, Circuit Judge:

The first question before us is whether there was any deductible loss in 1925 because of the cancellation of the contract between Artemas Ward and Interborough Rapid Transit on November 1, 1925. This depends on whether the deductions for exhaustion allowed to Artemas Ward between March 1, 1913, and March 13, 1922, when the latter transferred the contract to Artemas Ward, Inc. (N. Y.) in exchange for all the stock of that corporation should be added to the deductions for exhaustion allowed to Artemas Ward, Inc. (N. Y.) between the date of transfer and the time of cancellation. If the allowances granted to Artemas Ward and to his transferee Artemas Ward, Inc. (N. Y.) may all be taken into account, no part of the March 1, 1913, value of the contract would remain, so that there would be no deductible loss due to the cancellation on November 1, 1925.

[fol. 74] The contract transferred by Artemas Ward to Artemas Ward, Inc. (N. Y.) was acquired by the latter pursuant to such a non-taxable exchange as is described in Section 203 (b) (4) of the Revenue Act of 1926 which provides that:

"(4) No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock * * * in such corporation, and immediately after the exchange such person or persons, are in control of the corporation; * * *."

Section 204 (a) of the same Act provides that:

"The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913; shall be the cost of said property; except that—

"(8) If the property * * * was acquired after December 31, 1920, by a corporation by the issuance of its stock * * * in connection with a transaction described in paragraph (4) of subdivision (b) of Section 203 * * *, then the basis shall be the same as it would be in the hands

of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made;"

In spite of the fact that the transfer of the contract from Artemas Ward to Artemas Ward, Inc. (N. Y.) was under Section 203 (b) (4) supra a non-taxable exchange and the basis for determining the disposition of the contract was under Section 204 (a) (8) the same as it would be in the [fol. 75] hand of the transferor, the petitioners argue that the basis should only be diminished by the amount of the deductions for exhaustion which were allowable after Artemas Ward, Inc. (N. Y.) acquired the contract. This argument is founded on Section 202 (b) of the Act of 1926 which says that in computing the amount of gain or loss from the disposition of property:

"(2) The basis shall be diminished by the amount of the deductions for exhaustion, wear and tear, obsolescence, amortization and depletion which have since the acquisition of the property been allowable in respect of such property under this Act or prior income tax laws;"

The petitioners contend that the word "acquisition" means acquisition to the taxpayer. But where there has been a non-taxable exchange we think the "acquisition" referred to is that of the transferor. It is impossible to see why different rules should be employed for determining profit or loss where items of exhaustion are or are not allowable and where property that has been the subject of a non-taxable exchange is sold or otherwise disposed of. The purpose of the statutory provisions we have quoted was to disregard the corporate intervention when computing gain or loss in such cases. Under Section 204 (a) (8) the basis is "the same as it would be in the hands of the transferor increased in the amount of gain and decreased in the amount of loss recognized to the transferor." To allow deductions for exhaustion under a different principle or in a more limited way would contravene the entire theory ap- [fol. 76] plicable to non-taxable exchanges. Perthur Holding Corp. v. Commissioner, 61 Fed. (2d) 785, (C. C. A. 2); American Compress & Warehouse Co. v. Bender, 70 Fed. (2d) 655. The Board of Tax Appeals properly took into

account items allowed for exhaustion when the contract was in the hands of the transferor and rightly disallowed any loss through cancellation because the value had already been exhausted.

It is now necessary to deal with the second point raised by the taxpayer. That is whether the loss on the sale of the 4,964 shares of Artemas Ward, Inc. (N. Y.) which the United Brokerage Company and its affiliates were entitled to was $2,167,785.56 as claimed, or was only $495,696.76, the loss allowed by the Board. This depends on what portion of the amount paid for the stock by United Brokerage Company is allocable to the stock of Artemas Ward, Inc. (N. Y.) and what portion to the stock of Artemas Ward, Inc. (Del.). This in turn depends on whether Article 1599 (2) of Regulations 69 should be applied in its original form or as it stood after amendment in 1929.

Section 203 (c) of the Act of 1926 provides that, if there is distributed, to a shareholder in a corporation, a party to a reorganization, stock in such corporation or in another corporation, a party to the reorganization, without the surrender by the shareholder of the stock originally held, no gain to the stockholder shall be recognized. Section 204 (a) (9) provided that where (as here) such distribution was made after December 31, 1923, "the basis, in the case of the stock in respect of which the distribution was made shall be apportioned, under rules and regulations prescribed by the Commissioner with the approval of the Secretary, between such stock and the stock or securities distributed."

The question is whether Article 1599 (2) supra applies in [fol. 77] its earlier form or as later amended on November 13, 1929. Before the amendment, Article 1599 (2) read thus:

"Where the stock distributed in reorganization is in whole or in part of a character or preference materially different from the stock in respect of which the distribution is made, the cost or other basis of the old shares of stock shall be divided between such old stock and the new stock in proportion, as nearly as may be, to the respective values of each class of stock, old and new, at the time the new shares of stock are distributed, and the basis of each share of stock will be the quotient of the cost or other basis of the class with which such share belongs, divided by the number of shares in the class. The portion of the cost or other

basis of the old shares of stock to be attributed to the shares of new stock shall in no case exceed the fair market value of such shares as of the time of their distribution."

Where the new stock is stock of a corporation different from the old, it has been treated as stock of "a character or preference materially different" within the meaning of the foregoing regulation. Accordingly, if Article 1599 (2) as it read at the time of the sale of the 4,964 shares of Artemas Ward, Inc. (N. Y.), be applied, the last sentence of (2) would entitle the United Brokerage Company to a loss of $2,167,785.56. This is because the portion of the cost of the old stock to be attributed to the new stock could not exceed the fair market value of the 100 shares of stock of [fol. 78] Artemas Ward, Inc. (Del.), at the time of the distribution of the latter. As we have shown in the statement of facts the value of the latter stock at that time was $961,952.86. If $961,952.86 be deducted from $3,414,345.63 (the cost of the shares of Artemas Ward, Inc. (N. Y.), to United Brokerage Company) there would remain $2,452,392.77 as the base or proportion of the cost of the old stock applicable thereto after the reorganization. If from $2,452,392.77 be deducted $234,967.21 of accounts receivable distributed by Artemas Ward, Inc. (N. Y.), to United Brokerage Company, and $49,640 realized by the Untied Brokerage Company from the sale of the 4,964 shares of stock of Artemas Ward, Inc. (N. Y.), we have a balance amounting to $2,167,785.56—the loss claimed by the taxpayer.

Limitation by the last sentence of Subd. (2) supra to the fair value of stock of Artemas Ward, Inc., (Del.) at the time of distribution would make the proportion of cost to United Brokerage Company represented by that stock only about 28%, though the Delaware Company had received 77.15% of the assets of the old company. Doubtless, because such a limitation was thought to attribute in situations like the present too small a proportion of the basic cost to the stock of the new corporation distributed to stockholders through a reorganization, the Commissioner amended Article 1599 (2) on November 13, 1929, by omitting the last sentence of Subdivision (2). Applying the regulation as amended, he computed the loss on the sale of the stock of Artemas Ward, Inc., (N. Y.) at $495,696.76. The Board by employing that loss in determining the income of

the affiliated corporations arrived at the income tax de-
[fol. 79] ficiencies under review. We cannot see that the method of apportionment required by the amendment was unreasonable and if the Commissioner had the right to apply the Regulation, as amended in 1929, to prior transactions under which the taxpayers would be entitled to deduct a larger loss, the decisions of the Board were right.

The taxpayers argue that the Commissioner had no right to apply the Regulations, as amended, to prior transactions and cite Arizona Grocery v. Atchison Ry., 284 U. S. 370, in support of their contention. But Gt. Northern Ry. v. Sunburst Co., 287 U. S. 358, indicates that the former decision does not govern the present situation. The latter decision shows that if under power to adopt Regulations delegated by Congress to the Commissioner authority is given to change the Regulations, the Regulations are to the extent of that power tentative as to any matters affected, and that the changed Regulations, if reasonable, may be applied retroactively. In Gt. Northern Ry. v. Sunburst, 287 U. S. 358, this principle was applied in the case of freight rates which had been charged under a power to fix and to change the same delegated by the State of Montana to its Board of Railroad Commissioners. The rates were afterwards lowered by the State Board and the shipper was allowed to recover the excess from the carrier. In Titsworth v. Commissioner, 73 Fed. (2d) 385, (C. C. A. 3) the very argument presented here of the inability of the Commissioner to apply amended Article 1599 (2) retroactively was made without avail. Cf. Burnet v. S. & L. Bldg. Corp., 288 U. S. 406.

There can be no doubt that Congress has power to make
[fol. 80] income tax laws retroactive. Brushaber v. Union Pac. Ry., 240 U. S. 11. This is especially true where they only affect deductions that may be taken from income, which are always matters of legislative favor. Under the Revenue Acts of 1924 and 1926 the Commissioner was given discretion to apply his regulations without retroactive effect if the reversal of a former ruling was not immediately occasioned by a decision of a court of competent jurisdiction. Act of 1924, § 1008 (a); Act of 1926, § 1108 (a). Under the Act of 1928, § 605 (c), the Commissioner was given the same discretion without the limitation as to how the change in his former ruling was occasioned. Under the Act

of 1934, § 506, the 1982 provision was practically reiterated. Each of these enactments shows that the Regulations of the Commissioner are to be regarded as tentative for the reason that amendments are retroactive unless stated to be otherwise. Accordingly the Regulations in question are to be treated as retroactive to the date of the law to which they are applicable.

Orders affirmed.

Manton, J., dissenting in a separate opinion.

[fol. 80½] [Endorsed:] United States Circuit Court of Appeals. Second Circuit. Manhattan General Equipment Co., against Commissioner of Internal Revenue. Collier Service Corporation, etc., against Commissioner of Internal Revenue. Opinion. Augustus N. Hand, C. J.

[fol. 81] UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

MANHATTAN GENERAL EQUIPMENT CO., Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE, Respondent.

COLLIER SERVICE CORPORATION, Formerly SUBWAY ADVERTISING CO., INC., Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE, Respondent.

MANTON, Circuit Judge (Dissenting).

This appeal involves income taxes for 1925 and 1926, of both petitioners. The questions presented are (1) where a corporation which acquired a contract in a nontaxable exchange for stock pursuant to a transaction described in § 203 (b) (4) of the Revenue Act of 1926, and hence under § 204 (a) (8), is required to use the basis of the transferor in measuring the loss from the cancellation of that contract, should that basis be reduced by the amount of deductions for exhaustion allowable to the corporation taxpayer only or by the total exhaustion allowable to both the taxpayer and the transferrer; and (2) whether the loss sustained in 1926

on the sale of stock, received in a non-taxable distribution [fol. 82] in pursuance of a plan of reorganization, should be determined upon the basis of regulations in effect in 1926 (Art. 1599, Regulations 69), or upon the basis of an amended regulation promulgated in 1929 (Art. 1599, Regulations 69).

Artemus Ward, prior to March 1, 1913, had a contract for advertising, vending and news selling privileges on the cars and stations of the subways and elevated railways of the Interborough Rapid Transit Co. The fair value of this contract was appraised by the Commissioner, as of March 1, 1913, at $3,028.096.42. March 13, 1922, Artemus Ward transferred this contract to a New York corporation, Artemus Ward Inc., in exchange for the stock of the corporation. The United Brokerage Company which filed a consolidated return with the petitioners, purchased the entire issued and outstanding capital stock of Artemus Ward Inc., consisting of 4,964 shares of no par value, on June 30, 1925, for $3,414,345.63. This contract was cancelled November 1, 1925. In the consolidated return filed by the United Brokerage Co. for 1925, the income and deductions of Artemus Ward Inc. were included for the period of July 1 to December 31, 1925. One deduction claimed by Artemus Ward Inc. was a loss resulting from the cancellation of the contract, and it was disallowed by the respondent. In the petition filed with the Board, petitioner claimed a deduction for the loss sustained, in the sum of $605,619.30. This was computed by reducing the March 1, 1913 valuation of $3,028,096.42 by annual deductions for the exhaustion of the life of the contract on the basis of a remaining life on March 1, 1913 of 15 5/6 years. The exhaustion so computed [fol. 83] amounted to $2,422,477.12, leaving an unexhausted March 1, 1913 value of $605,619.30. The respondent computed the amount of exhaustion allowable both to the transferor Artemus Ward, the individual, and to the transferee, Artemus Ward Inc., in terms of March 1, 1913 value, at the rate of $191,248.20 per year, except in 1922 and 1923, when an allowance was permitted for exhaustion of the contract in the amount of $766,642.59 for each of the two years. The deductions allowable for exhaustion of the contract during the period it was owned by Artemus Ward Inc. were $613,-314.07 for 1922, and $766,642.59 for 1923, based upon the

value at the date of the acquisition of the contract by Artemus Ward, Inc. on March 13, 1922.

The plan of reorganization referred to in the prevailing opinion became effective during 1925, and in 1926, the United Brokerage Co. sold the shares of Artemus Ward Inc. (N. Y.) for $49,640.

In its return for 1926, the United Brokerage Co. claimed a deduction of $3,062,314.54 as a loss resulting from the sale of the stock of Artemus Ward Inc. (N. Y.). This loss was computed in accordance with the provisions of subdiv. (1) of Art. 1599, Regulations 69, then in effect for sales made in 1926. But the respondent applied the provisions of Art. 1599 (2) of Regulations 69, as amended November 13, 1929, and determined the loss sustained to be $495,696.76. The distribution to the United Brokerage Co. on December 31, 1925, of the stock of Artemus Ward Inc. (Del.), worth $961,952.86 and accounts receivable worth $234,967.21 was followed, in December 1926, by the sale of the stock of the Artemus Ward Inc. (N. Y.) for $49,640 and this made it possible to ascertain the amount of the loss which had been [fol. 84] sustained by the parent company. It paid $3,414,345.63 for the stock of the New York corporation, and it received assets worth only $1,246,560.07 and therefore suffered a loss of $2,167,785.56 on the transaction.

Pursuant to § 204(a) (8), the basis for determining the gain or loss from the sale of the contract in the hands of Artemus Ward Inc. was the same as it would be in the hands of Artemus Ward the transferor—$3,028,086.42. The reason the loss sustained by cancellation of the contract was disallowed, was that the aggregate amount of the deductions allowed or allowable for the exhaustion of the contract to Artemus Ward, the transferor, from March 1, 1913 to March 13, 1922, and to Artemus Ward Inc. subsequent to the time said contract was acquired by it on March 13, 1933, and prior to November 1, 1925, was in excess of the basis of $3,028,096.42. Under the provisions of § 202(b) (2) of the Revenue Act of 1926, the basis to Artemus Ward Inc. of $3,028,096.42 is reduced only by the aggregate of deductions allowable to it for exhaustion of such contract during the period the contract was owned by it. The aggregate amount of the deductions allowable to it for the exhaustion was $1,730,578.36; thus Artemus Ward Inc. suffered a loss of $1,297, 518.06. The value of this contract

to the transferee, Artemus Ward Inc., must be computed undiminished by any exhaustion allowed or allowable to the transferor, Artemus Ward. It should not include any deductions for exhaustion which may have been allowed or allowable to the transferor Artemus Ward prior to March 13, 1922.

[fol. 85] Section 203(c) of the Revenue Act of 1926 provides that if there was distributed to a shareholder in a corporation a party to a reorganization, stock in such corporation or in another corporation a party to the reorganization, without the surrender of the stock originally held, no gain to the shareholder should be recognized. Section 204 (a) (9) provides that in such cases the basis of the old stock should be apportioned between the old and new stock under rules and regulations prescribed by the Commissioner. Regulations 69, Art. 1599, promulgated August 28, 1926, provided that where the new stock was of substantially the same character or preference as the old stock, the basis of each share should be determined by dividing the cost of the old stock by the total number of old and new shares. Paragraph 2 provided that where the new stock was of a character or preference materially different from the old stock, the cost of the latter should be divided between the old and the new stock in proportion to the respective values of each class of stock at the time of distribution, but with the proviso that the basis of the old shares of stock to be attributed to the new stock shall in no case exceed the fair market value of such shares as of the time of their distribution. Thus, if the allocation is to be made under para. 2 of Art. 1599, the cost of the old stock should be divided between the old and the new in proportion to the respective values of each class; the amount to be attributed to the new stock not to exceed the value of such stock under the limitation contained in the article as then promulgated. The value of the new stock was $961,952.86; the remainder of the [fol. 86] cost of $3,414,345.63, that is, $2,452,392.77, should be allocated to the old stock, and after deducting the accounts receivable and the sum received when the old stock was sold, there was a loss of $2,167,785.56. This is the actual loss sustained by the United Brokerage Co. as shown in the statement of facts.

The prevailing opinion holds that the original article is inapplicable by reason of the promulgation, on November

13, 1929, of an amendment to Art. 1599 of Regulations 69, providing explicitly that where the stock distributed was stock in a corporation other than the distributing corporation, the basis of the old stock should be apportioned under para. 2 of the article, omitting the last sentence of the original article. The prevailing opinion thus applies the amended article to the distribution made by Artemus Ward Inc. on December 31, 1925, retroactively. Great Northern Ry. v. Sunburst Co. (287 U. S. 358) is relied upon.

In Arizona Grocery Co. v. Atchison, T. & S. F. Ry. Co. (284 U. S. 370), the holding of the court was that when the Interstate Commerce Commission declares a certain rate to be a reasonable rate, it speaks as the legislature and its pronouncement has the force of a statute, the Interstate Commerce Commission in naming the rate, speaking in a quasi-legislative capacity. This being so, the court held that the Interstate Commerce Commission cannot, by a later provision, declare its own finding of reasonableness to be erroneous and subject a carrier which conformed thereto, to a reparation measured by what the Interstate Commerce Commission later holds it should previously have [fol. 87] decided. The Great Northern Ry. case (supra), in no way changed this holding. In that case, the court held that where it is clear to all concerned that a rate as fixed is but tentative and provisional, the rate may be changed retroactively. The court found that notice had been given to all that the rate was subject to retroactive change. The court said that the Arizona case (supra), was not in conflict with such view, because Congress had not there intended that the Interstate Commerce Commission have power to change rates retroactively. The Great Northern case in no way implied, as might be concluded from the prevailing opinion, that the mere power to change regulations makes such regulations only tentative, and therefore capable of being applied retroactively when changed. The very "meat" of the Great Northern case was that all concerned knew and understood that the rates, as fixed, were originally tentative, not that they were simply subject to change. Where regulations are only subject to change, but are not understood to be tentative, the Arizona case (supra) applies, and they cannot be applied retroactively.

Prior to the enactment of the 1926 Act, the authority of the Commissioner arbitrarily to decide whether or not later

regulations were to be applied retroactively was seriously questioned. As a result, the Act of 1926 (§1108[a]) gave the Commissioner a wide discretion. The discretion was not to apply it with retroactive effect, but without retroactive effect. The 1928 Act is in the same terms (§605, Act of 1928). "The purpose of the above provision of law is to prevent the constant reopening of cases on account of [fol. 88] changes in regulations or treasury decisions." Prentice-Hall Tax Service (1934) §21,207. The 1934 Act (§506) provides that the Secretary or Commissioner, with the former's approval, may prescribe the extent, if any, to which any regulation shall be applied "without retroactive effect". See: Report Ways & Means Committee, 1934.*

The retroactivity of an amended regulation may depend upon whether the regulation under discussion declares the law or merely interprets it. If the latter, then the regulation, in reality, has no retroactive effect of itself. [fol. 89] The regulation would be only interpretive of the statute which imposes the tax. If, on the other hand, it is declarative of the law, then the amended regulation might well be invalid if it adversely and unjustly affected the taxpayer. The Report of the Ways and Means Committee recognized the distinction and also that those regu-

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* "The amendment tends the right granted by existing law to the Treasury Department to give regulations and Treasury Decisions amending prior regulations or treasury decisions prospective effect only, by allowing the Secretary, or the Commissioner with the approval of the Secretary, to prescribe the exact extent to which any regulation or Treasury decision, whether or not it amends a prior regulation or treasury decision, will be applied without retroactive effect. * * *" "*Regulations, * * * which are merely interpretive of the statute, will normally have a universal application, but in some cases the application of regulations, * * *, to past transactions which have been closed by taxpayers in reliance upon existing practice, will work such inequitable results that it is believed desirable to lodge in the Treasury Department the power to avoid these results by applying certain regulations, * * * with prospective effect only.*" [Prentice-Hall Federal Tax Service, (1935) §21, 207.]

lations which are of a nature other than merely interpretive, often work inequitable results when applied retroactively. This fact, which was considered a reason for giving the Commissioner discretion to apply regulations non-retroactively, is also a reason for refusing to give a retroactive effect to an amended regulation even though the Commissioner does not exercise his discretion.

Congress di dnot declare, in § 204 (a) (9), the method by which the basis should be apportioned. Rather, it delegated to the Commissioner the power to make rules and regulations for such apportionment with the approval of the Secretary. To say that the Commissioner is merely interpreting the law in such case, is erroneous. Before the Commissioner promulgated Article 1599 of Regulation 69, there was no law in regard to the method to be used in apportioning the basis, and the Commissioner, when he promulgated the article, made the law. The Regulation was not interpretive of the law, because before the Regulation there was no law. The Commissioner acted in what the Supreme Court, in the Arizona Grocery case, supra, called a quasi-legislative manner. Regulations made by the Commissioner in pursuance of his delegated authority, with the Secretary's approval, have the force and effect of statutes. U. S. v. Eliason, 16 Pet. 291; In re Huttman, 70 Fed. 699. And [fol. 90] so, when the Commissioner, in accordance with his delegated power, acts in behalf of Congress in enacting such a regulation as is considered in the instant case, the regulation promulgated by him will be considered declarative of the law, and quasi-legislative in nature. Consequently, the regulation should not be applied with retroactive effect. To do so would be unreasonable and capricious. Untermyer v. Anderson, 276 U. S. 440; Nichols v. Coolidge, 274 U. S. 531; Arizona Grocery Co. v. Atchison, T. & S. F. Ry. Co., supra.

The deduction should be allowed and the decision reversed.

[fol. 90½] [Endorsed:] United States Circuit Court of Appeals, Second Circuit. Manhattan General Equipment v. Commr. of Internal Revenue. Dissenting Opinion. Manton, Circuit Judge.

[fol. 91] UNITED STATES CIRCUIT COURT OF APPEALS, SECOND CIRCUIT

At at Stated Term of the United States Circuit Court of Appeals, in and for the Second Circuit, held at the Court Rooms in the Post Office Building in the City of New York, on the 22nd day of April, one thousand nine hundred and thirty-five.

Present: Hon. Martin T. Manton, Hon. Augustus N. Hand, Hon. Harrie B. Chase, Circuit Judges.

Appeal from the United States Board of Tax Appeals

This cause came on to be heard on the transcript of record from the United States Board of Tax Appeals, and was argued by counsel.

On consideration whereof, it is now hereby ordered, adjudged, and decreed that the order of said United States Board of Tax Appeals be and it hereby is affirmed.

It is further ordered that a Mandate issue to the said Board in accordance with this decree.

Wm. Parkin, Clerk.

[fol. 92] [Endorsed:] United States Circuit Court of Appeals, Second Circuit. Manhattan General Equipment Co. vs. Commissioner of Internal Revenue. Order for Mandate. United States Circuit Court of Appeals, Second Circuit. Filed April 22, 1935. William Parkin, Clerk.

[fol. 93] [Stamp:] United States Circuit Court of Appeals, Second Circuit. Filed Apr. 29, 1935. William Parkin, Clerk.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

MANHATTAN GENERAL EQUIPMENT COMPANY, Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE, Respondent

COLLIER SERVICE CORPORATION, Formerly Subway Advertising Co., Inc., Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE, Respondent

On Petitions for Review of Decisions of the United States Board of Tax Appeals

PETITION FOR A REHEARING

Come now the petitioners, Manhattan General Equipment Company and Collier Service Corporation, formerly Broadway Subway Advertising Co., Inc., by their attorneys, and petition this honorable court for a rehearing in the above entitled causes in which the opinions were filed on April 15, 1935. In support of this petition petitioners assign the following reasons:

[fol. 94] (1) The finding of this court that the loss sustained by United Brokerage Company as a result of the sale in December, 1926, of 4,964 shares of Artemas Ward, Inc. (N. Y.) should be determined under Article 1599 (2) of Regulations 69 as amended November 13, 1929 was based upon Great Northern Railway Company v. Sunburst Oil and Refining Company, 287 U. S. 358, which was not cited or relied upon by either of the parties in the proceedings before this honorable court, and with respect to which the petitioners have not had an opportunity to give this honorable court the benefit of their views regarding the inapplicability of that decision to the issue presented in these proceedings.

(2) It is the view of the petitioners that the application by this court of the decision in Great Northern Railway Co. v. Sunburst Oil and Refining Company, supra, was erroneous in at least two respects.

(a) It was implied that the United States Supreme Court had approved the retroactive amendment of quasi-legislative regulations, whereas that court definitely declined to express any opinion upon the legality of such amendments.

The Board of Railroad Commissioners of Montana had made a retroactive change in the rates for the carriage of freight, and the respondent had recovered a judgment against the complainant which was affirmed upon appeal. In an earlier case, Doney v. Northern Pacific Railway Co., 60 Mont. 209, 199 Pac. 432, which had been decided prior to the collection of the charges complained of in the Great Northern case, the Montana Supreme Court had indicated [fol. 95] that such actions for restitution might be maintained against the carrier, under certain conditions, if the Board determined retroactively that the rates were excessive. The United States Supreme Court held that this earlier decision had written into the Montana statute a notice to all concerned that payments exacted by a carrier were subject to be refunded if found thereafter to be excessive, and that no Federal right was infringed by giving to the statute the meaning that had been ascribed to it by the Montana court, since no such impairment would have resulted if the meaning had been written into the statute by the legislature. The United States Supreme Court did not endorse the interpretation placed upon the statute by the Montana court, but held that the meaning of the Montana statute was a problem for the Montana courts, and not subject to review by itself.

(b) It was implied that the Supreme Court of Montana had approved the retroactive amendment of quasi-legislative regulations, whereas although that court had approved such amendment in an earlier decision, it held in this case that such retroactive amendments were wrong in principle and would not be sustained in the case of future transactions.

The case of Doney v. Northern Pacific Railway Co., supra, in which the court affirmed the shipper's right to recover charges held retroactively to be excessive, was decided in

1921. The transactions complained of in Great Northern Railway Co. v. Sunburst Oil and Refining Company, supra, occurred between August, 1926 and August, 1928. While the Montana Supreme Court held in that case that the ruling in the Doney case was law until reversed and would con- [fol. 96] stitute the governing principle for shippers and carriers who, during the period of its reign, had acted on the faith of it, the court nevertheless decided that the ruling in the Doney case was erroneous and would not be followed with reference to future transactions. The court further held that a rate established by the Commission had the same effect as one established by the legislature, and that the statute giving power to the Commission or the court to declare a rate unreasonable was not to be read as meaning that the declaration of invalidity should apply to intermediate or completed transactions, i. e., should not authorize retroactive changes in rates. The effect of the revised interpretation of the Montana statute announced by the Montana Supreme Court in this case as the principle to be applied with respect to future transactions, is identical with the interpretation placed upon the Federal statute by the United States Supreme Court in the case of Arizona Grocery Co. v. Atchison, Topeka and Santa Fe Railroad Company, 284 U. S. 370. Both of these courts have now in effect held that when an administrative agency declares a certain rate to be a reasonable rate it speaks as the legislature and its pronouncement has the force of statute, and such administrative body can not by a later amendment of its regulations declare its own finding to be erroneous, and subject a carrier which conformed thereto to reparation measured by its later declaration.

Laurence Graves, Southern Bldg., Washington, D. C.
Arthur M. Kracke, Rookery Bldg., Chicago, Ill.

[fol. 97] Certificate of Counsel

The undersigned counsel for petitioners hereby certify that in their judgment the foregoing petition is well founded and is not interposed for delay.

Laurence Graves, Arthur M. Kracke.

[fol. 98] UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

MANHATTAN GENERAL EQUIPMENT COMPANY, Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE, Respondent

COLLIER SERVICE CORPORATION, Formerly SUBWAY ADVERTISTISING CO., INC., Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE, Respondent

Before Manton, Augustus N. Hand and Chase, Circuit Judges

Laurence Graves, Esq., Arthur M. Krack, Esq., Counsel for Petitioners.

Per CURIAM:

Petition for rehearing denied.

—— ——, United States Circuit Judges.

Filed May 22, 1935.

[fol. 99] UNITED STATES CIRCUIT COURT OF APPEALS, SECOND CIRCUIT

At a stated term of the United States Circuit Court of Appeals, in and for the Second Circuit, held at the Court Rooms in the Post Office Building in the City of New York, on the 22nd day of May, one thousand nine hundred and thirty-five.

Present: Hon. Martin T. Manton, Hon. Augustus N. Hand, Hon. Harrie B. Chase, Circuit Judges.

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MANHATTAN GENERAL EQUIPMENT COMPANY, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

COLLIER SERVICE CORPORATION, Formerly SUBWAY ADVERTISING CO., INC.,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

A petition for a rehearing having been filed herein by counsel for the petitioners;

Upon consideration thereof it is

Ordered that said petition be and hereby is denied.

Wm. Parkin, Clerk.

[fol. 100] [Endorsed:] United States Circuit Court of Appeals, Second Circuit. Manhattan General Equipment Company v. Commissioner of Internal Revenue. Collier Service Corporation v. Commissioner of Internal Revenue. Order. United States Circuit Court of Appeals, Second Circuit. Filed May 22, 1935. William Parkin, Clerk.

[fol. 101] UNITED STATES OF AMERICA,
Southern District of New York:

I, William Parkin, Clerk of the United States Circuit Court of Appeals for the Second Circuit, do hereby certify that the foregoing pages, numbered from 1 to 100, inclusive, contain a true and complete transcript of the record and proceedings had in said Court, in the case of Manhattan General Equipment Company, Petitioner, against Commissioner of Internal Revenue, Respondent, as the same remain of record and on file in my office.

In testimony whereof, I have caused the seal of the said Court to be hereunto affixed, at the City of New York, in the Southern District of New York, in the Second Circuit, this first day of July, in the year of our Lord one thousand nine hundred and thirty-five, and of the Independence of the said United States the one hundred and fifty-ninth.

Wm. Parkin, Clerk. (Seal United States Circuit Court of Appeals, Second Circuit.)

[fol. 96] SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed October 14, 1935

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

FILE COPY

Office Supreme Court, U. S.
FILED
JUL 8 1935
CHARLES ELMORE CROPLEY
CLERK

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1935.

No. 226

MANHATTAN GENERAL EQUIPMENT COMPANY,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE.

No. 227

COLLIER SERVICE CORPORATION, FORMERLY BROADWAY SUBWAY ADVERTISING CO., INC.,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE.

PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT AND BRIEF IN SUPPORT THEREOF.

LAURENCE GRAVES,
Counsel for Petitioners.

SAMUEL H. KAUFMAN,
EMIL WEITZNER,
Of Counsel.

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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1935.

No. 226

No. 51,345 in the Circuit Court of Appeals.

MANHATTAN GENERAL EQUIPMENT COMPANY,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE.

No. 227

No. 57,372 in the Circuit Court of Appeals.

COLLIER SERVICE CORPORATION, FORMERLY BROADWAY SUBWAY ADVERTISING CO., INC.,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE.

PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

MAY IT PLEASE THE COURT:

The petitioners, Manhattan General Equipment Company and Collier Service Corporation, by Laurence Graves, Esq., their attorney, pray that writs of certiorari issue to review

the judgments of the United States Circuit Court of Appeals for the Second Circuit (R. 84), affirming the orders of the United States Board of Tax Appeals (R. 53).*

A.

Summary Statement of Matter Involved.

The case was submitted upon an agreed statement of facts (R. 29-41), which may be summarized as follows:

Each of the petitioners was, during the years 1925 and 1926, one of a group of affiliated corporations, the gross income and deductions of which were included in consolidated income tax returns filed by the United Brokerage Company (R. 31).

On June 30, 1925, United Brokerage Company acquired at a cost of $3,414,345.63 the capital stock of Artemas Ward, Inc., a New York corporation, consisting of 4,964 shares of stock (R. 36). One of the assets of Artemas Ward, Inc., was a contract with the Interborough Rapid Transit Company controlling advertising and vending privileges in subways and elevated railways in the City of New York (R. 34, 36). This contract, which by its terms was to continue to December 31, 1928 (R. 34), was cancelled by the Transit Commission of the State of New York on November 1, 1925 (R. 36).*

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* The cases arise upon identical records, were argued together in the Circuit Court of Appeals and disposed of by that Court in a single opinion.

* For the year 1925 United Brokerage Company claimed as a loss to Artemas Ward, Inc., by reason of the cancellation of the Interborough contract, the difference between the March 1, 1913 value of the contract and deductions theretofore allowed Artemas Ward, Inc., in its tax returns for 1922, 1923, and 1924, on account of the exhaustion of the March 1, 1913 value of the contract. The Commissioner

On December 31, 1925, Artemas Ward, Inc., had net assets of a fair value of $1,246,920.07 (R. 37). On that date Artemas Ward, Inc., in pursuance of a plan of reorganization, transferred assets, subject to liabilities, having a net value of $961,952.86 to Artemas Ward, Inc., a Delaware corporation, in exchange for 100 shares of the stock of the Delaware corporation. On the same day, but after the transfer, Artemas Ward, Inc., the New York corporation, pursuant to the plan of reorganization distributed to United Brokerage Company the 100 shares of stock of the Delaware corporation together with accounts receivable amounting to $234,967.21. After this distribution the assets of

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of Internal Revenue disallowed the deduction sought for 1925. His decision was affirmed by the Board of Tax Appeals, and the latter affirmed by the Circuit Court of Appeals. The petitioners do not seek review of that determination. The sole issue presented concerns the tax for the next year, 1926.

Since, however, the question of the 1925 taxes is disposed of in the opinion of the Circuit Court of Appeals, the following brief statement of the issue there considered may help to delimit the present question: On March 13, 1922 Artemas Ward, an individual, transferred certain assets, including the Interborough contract, to Artemus Ward, Inc., in exchange for the latter's entire capital stock. Prior to that time Artemas Ward had been allowed in computing his net income to deduct certain amounts on account of the exhaustion of the March 1, 1913, value of the Interborough contract. These deductions, together with the deductions subsequently allowed to Artemas Ward, Inc., more than equalled the March 1, 1913, value of the contract. The Commissioner of Internal Revenue ruled that the acquisition of the contract by Artemas Ward, Inc., having been a nontaxable transaction, the deductions allowed to the individual and to the corporation were both to be considered in determining the unexhausted basis of the contract to Artemas Ward, Inc.

Artemas Ward, Inc., the New York corporation, consisted of $50,000 cash (R. 37). In December 1926 United Brokerage Company sold to an outside party for $49,640 the 4,964 shares of the stock of Artemas Ward, Inc., the New York corporation (R. 37, 38).

United Brokerage Company paid for the stock of Artemas Ward, Inc., the New York corporation (R. 36)	$3,414,345.63
By sale or other disposition, it received for its investment an aggregate of	$1,246,560.07
made up as follows (R. 37):	
(a) stock of Artemas Ward, Inc., the Delaware corporation, having a value when received of	$ 961,952.86
(b) accounts receivable to Artemas Ward, Inc., the New York corporation, aggregating	234,967.21
(c) from the sale of the stock of Artemas Ward, Inc., the New York corporation	49,640.00
	$1,246,560.07
Thus, United Brokerage Company suffered an actual loss upon its investment of	$2,167,785.56

Upon the basis of these transactions the petitioners claim that a deduction of $2,167,785.56 should properly be allowed to United Brokerage Company for 1926. The Commissioner of Internal Revenue in re-computing the tax for 1926 allowed a deductible loss of only $495,696.76 and determined deficiencies for 1926 accordingly.

It is not questioned that the reorganization when consummated was a non-taxable transaction under the provisions of Section 203 (c) of the Revenue Act of 1924, which section was reenacted into the Revenue Act of 1926 without change. The only issue in the case relates to the basis to

be given to the stock of Artemas Ward, Inc., the New York corporation, in December 1926, when it was sold by the United Brokerage Company.

Section 204 (a) (9) of the Revenue Act of 1926, a reenactment without change of that section of the Revenue Act of 1924, provides that for the purpose of determining the basis of the old and the new stocks in such a reorganization as was here consummated, the cost of the old stock shall be apportioned between the old and new stocks "under rules and regulations prescribed by the Commissioner with the approval of the Secretary." Pursuant to such authority, the Commissioner on October 6, 1924, promulgated Article 1599(2) of Regulations 65 prescribing the basis of apportionment applicable to reorganizations under Section 204(a) (9) of the Revenue Act of 1924. Article 1599(2) was again promulgated with immaterial changes on August 28, 1926, under Regulations 69 issued pursuant to the Revenue Act of 1926. Under Article 1599(2) as thus promulgated the cost of the stock of the old corporation was to be apportioned between its stock and the stock of the new corporation in the ratio of the value, upon the reorganization, of the old and new stocks, but with the proviso that in no event should the cost to be attributed to the new stock be greater than the value of the new stock at the time of the reorganization. Under this formula the cost to be attributed to the 100 shares of the stock of Artemas Ward, Inc., the Delaware corporation, was $961,952.86, its actual value.

On April 3, 1928, the Commissioner promulgated Treasury Decision 4144, which amended Article 1599(2) of Regulations 69 so as to eliminate the provision that the cost to be apportioned to the new stock should not exceed its value at the time of the reorganization. On November 13, 1929, the Commissioner of Internal Revenue promulgated Treasury Decision 4274 reaffirming the 1928 amendment of Ar-

ticle 1599(2) and extending its application to Regulations 65.*

Applying the amended Article 1599(2) retroactively, the Commissioner redetermined the cost to be apportioned to the stock of Artemas Ward, Inc., the Delaware corporation, at $2,634,041.66 (R. 39, 40). This resulted in reducing the cost apportioned to the stock of Artemas Ward, Inc., the New York corporation, to $780,303.97. Upon the readjusted basis of cost, the Commissioner determined the amount of the loss sustained by the United Brokerage Company upon the sale of the stock of the New York corporation to be $495,696.76 (R. 39, 40).

The Board of Tax Appeals approved the Commissioner's determination. The Circuit Court of Appeals, one of the judges dissenting, affirmed the Board of Tax Appeals and held that Article 1599(2) of the Regulations promulgated by the Commissioner pursuant to Section 204(a)(9) was tentative in character and that authority to amend the regulation retroactively was implied by Section 1008(a) of the Revenue Act of 1924 and 1108(a) of the Revenue Act of 1926. In so holding the Circuit Court of Appeals overruled the petitioners' contention that Article 1599(2) of the Regulations was legislative in character, that Section 1108(a) permitting non-retrospective amendment of interpretative regulations implies no authority to the Commissioner to amend legislative regulations retroactively, and that the Commissioner of Internal Revenue was without authority to amend and apply Article 1599(2) retroactively.

The question presented, therefore, is:

Where the Revenue Acts provide that the basis for ascertaining gain or loss with respect to stocks received or re-

* Decision 4274 also added certain matter, which concededly was declaratory of the interpretation previously given by the Commissioner to the unamended article, and which is immaterial here.

tained in a non-taxable reorganization shall be prescribed by the Commissioner of Internal Revenue under regulations to be promulgated by him, is the basis governed by a regulation promulgated by the Commissioner which is in effect at the time that a plan of reorganization is consummated and at the time that property is sold, or is it governed by a regulation prescribed by an amendment promulgated more than two years subsequent to those transactions?

More specifically, is Article 1599(2) of the Regulations promulgated by the Commissioner of Internal Revenue under the power granted by Section 204(a)(9) of the Revenue Act legislative in character, is authority to amend it retroactively to be implied from Sections 1008(a) and 1108(a), or, if such authority is not there implied, may the Commissioner nevertheless amend the regulation retroactively and apply it to completed transactions?

B.

Reasons Relied on for Granting the Writ.

The Circuit Court of Appeals has decided an important question of federal law which has not been, but should be, settled by this Court. The Commissioner in promulgating the regulations under authority of Section 204(a)(9), in no sense merely interpreted the law. Prior to the issuance of his regulation there was no law providing for apportioning the cost between the stock originally held and the stock distributed pursuant to the plan of reorganization. Under the decision of this Court in *Arizona Grocery Company* v. *Atchison, Topeka & Santa Fe Ry. Co.*, 284 U. S. 370, the Commissioner must be held to have acted in a quasi-legislative manner in promulgating Article 1599(2). Under that decision of this Court the Commissioner was, therefore, without authority to amend retroactively the regulation

promulgated by him and acted upon by the petitioners. Whether or not Congress might have authorized the Commissioner to amend the regulations retroactively is not an issue in this case, since Congress has not done so. Hence the case of *Great Northern Railway Company* v. *Sunburst Oil and Refining Company,* 287 U. S. 358, upon which the majority of the Circuit Court of Appeals rested their decision, is inapplicable.

Ever since the enactment of the Revenue Act of 1924, and the continuance in subsequent acts, with minor changes, of elaborate, precise and comprehensive provisions governing the taxability upon the sale or other disposition of stock received or retained in connection with reorganizations, taxpayers and their counsel have acted and advised in reliance upon the plain propositions of Article 1599(2) promulgated under the authority of Section 204(a) 9). It was a matter of indifference to the petitioners' affiliate, the United Brokerage Company, in what proportions the assets of the New York corporation, whose stock it wholly owned, should be distributed between the New York and Delaware corporations under the plan of reorganization. If the Commissioner had promulgated in the first instance the regulation he sought to effect retroactively more than two years later, United Brokerage Company could have reduced the amount of the net assets transferred to the Delaware corporation, so that while such assets would have been more than ample for the latter's business needs, the proportion of assets transferred and retained would have been such as to permit substantially all of the loss to United Brokerage Company of $2,167,785.56 to be realized upon the sale of the stock of the New York corporation.*

The petitioners are not in the position of tax evaders. On the contrary, the Commissioner occupies the role of one

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* See detailed analysis, infra, pp. 19-21.

who has prescribed a "rule of the road" entirely fair and reasonable in its application to the petitioners and their affiliates and has then sought retroactively to change his ruling. Thus, although the United Brokerage Company could have proceeded safely and properly under the amended rule, the Commissioner seeks to penalize it for not having the prescience to anticipate that he would change his ruling in the particular in which Article 1599(2) was modified.

WHEREFORE your petitioners respectfully pray that writs of certiorari be issued out of and under the seal of this Honorable Court directed to the Circuit Court of Appeals for the Second Circuit, commanding that Court to certify and to send to this Court for its review and determination on a day certain to be therein named the full and complete transcripts of the records and all proceedings in the cases numbered and entitled on its docket "No. 51,345, *Manhattan General Equipment Company, Petitioner,* v. *Commissioner of Internal Revenue, Respondent*" and "No. 51,372 *Collier Service Corporation, Petitioner,* v. *Commissioner of Internal Revenue, Respondent,*" and that said judgments of the Circuit Court of Appeals for the Second Circuit may be reversed by this Honorable Court, and your petitioners may have such other and further relief in the premises as to this Honorable Court may seem meet and just; and your petitioners will ever pray.

July 9, 1935.

MANHATTAN GENERAL EQUIPMENT COMPANY,
COLLIER SERVICE CORPORATION,
By LAURENCE GRAVES,
Attorney for Petitioners.

BRIEF IN SUPPORT OF PETITION FOR WRITS OF CERTIORARI.

I.

Opinions Below.

The opinion in the United States Board of Tax Appeals in *Manhattan General Equipment Co.* v. *Commissioner of Internal Revenue,* 29 B. T. A. 395 (R. 42); the opinion of the Circuit Court of Appeals for the Second Circuit is reported in *Manhattan General Equipment Co.* v. *The Commissioner of Internal Revenue,* 76 F. (2d) 892 (R. 69).

II.

Jurisdiction.

This Court has jurisdiction to review the judgments below under Section 240(a) of the Judicial Code as amended by the Act of February 13, 1925, 43 Stat. 938. The date of the judgment sought to be reviewed is April 22, 1935 (R. 54). On May 22, 1935 the Circuit Court of Appeals denied petitions for rehearing, without opinion (R. 88).

III.

Statutes and Regulations Involved.

These are set forth in the Appendix, *infra,* pp. 22-30.

IV.

Statement of the Case.

The facts of the case are fully stated in the accompanying petition for certiorari, at pp. 1-6.

V.

Specification of Errors.

1. The Circuit Court of Appeals erred in holding that the loss sustained by United Brokerage Company in 1926 upon

the sale of the stock of Artemas Ward, Inc. should be computed in accordance with the provisions of Article 1599(2) of Regulations 69, as amended and revised on April 3, 1928 and November 13, 1929.

2. The Circuit Court of Appeals erred in holding that authority of the Commissioner of Internal Revenue to amend retroactively the provisions of Article 1599(2) of Regulations 65 and 69 promulgated October 6, 1924 and August 28, 1926, respectively, may be implied from Section 1008(a) of the Revenue Act of 1924 and Section 1108(a) of the Revenue Act of 1926.

3. The Circuit Court of Appeals erred in failing to hold that the provisions of Article 1599(2) of Regulations 65 and 69 promulgated October 6, 1924 and August 28, 1926, respectively, were legislative in character and that the Commissioner of Internal Revenue was without power or authority to amend such provisions so as to apply retroactively to the petitioners.

4. The Circuit Court of Appeals erred in affirming the decision of the Board of Tax Appeals which sustained the Commissioner of Internal Revenue.

VI.

ARGUMENT.

A. Article 1599(2) of Regulations 65 and 69 promulgated by the Commissioner of Internal Revenue on October 6, 1924 and August 28, 1926, respectively, was legislative in character; and since

B. No implication may be drawn from Section 1008(a) of the Revenue Act of 1924 and Section 1108(a) of the Revenue Act of 1926, that the Commissioner of Internal Revenue is authorized to amend Article 1599(2) retroactively; hence

C. The basis for measuring the loss to petitioners' affiliate from the sale of the stock of Artemas Ward, Inc., is to be determined under Article 1599(2) as originally promulgated.

A.

Article 1599(2) of Regulations 65 and 69 promulgated by the Commissioner of Internal Revenue on October 6, 1924, and August 28, 1926, respectively, was legislative in character.

Section 203(c) of the Revenue Acts of 1924 and 1926 provides that if there is distributed to a shareholder in a corporation a party to a reorganization, stock in such corporation or in another corporation a party to the reorganization without the surrender of the stock originally held, no gain or loss to the shareholder shall be recognized. Section 204(a)(9) of these Acts provides, that in such a case, for the purpose of determining the gain or loss from a subsequent sale or other disposition, the basis of the old stock shall be apportioned between the old and the new stocks under regulations prescribed by the Commissioner of Internal Revenue. Until such regulations are prescribed there is no law in regard to the method to be used in apportioning the basis.

When the Commissioner acting pursuant to the power delegated to him under Section 204(a)(9) promulgates Article 1599(2) he is, we believe, in no sense interpreting the Revenue Act. Article 1599(2) does not purport to state the meaning of the Revenue Act. It is declarative of the law, and quasi-legislative in nature. In promulgating Article 1599(2) the Commissioner "speaks as the legislature" and his pronouncement "has the force of a statute". *Arizona Grocery Co.* v. *Atchison, Topeka & Santa Fe Railway Co.*, 284 U. S. 370, 386.

B.

No implication may be drawn from Section 1008(a) of the Revenue Act of 1924 or Section 1108(a) of the Revenue Act of 1926 that the Commissioner of Internal Revenue is authorized to amend Article 1599(2) retroactively.

Section 1108(a) of the Revenue Act of 1926, which is identical with Section 1008(a) of the Revenue Act of 1924 and Section 1314 of the Revenue Act of 1921, provides

> "In case a regulation or Treasury decision relating to the internal-revenue laws, made by the Commissioner or the Secretary, or by the Commissioner with the approval of the Secretary, is reversed by a subsequent regulation or Treasury decision, and such reversal is not immediately occasioned or required by a decision of a court of competent jurisdiction, such subsequent regulation or Treasury decision may, in the discretion of the Commissioner, with the approval of the Secretary, be applied without retroactive effect."

Under Section 605 of the Revenue Act of 1928, the Commissioner was given the same discretion without limitation as to how the change in his former ruling was occasioned. Under Section 506 of the Revenue Act of 1934, the 1928 provision was reiterated and extended to cover internal-revenue rulings as well as regulations and Treasury decisions.

The majority of the Circuit Court of Appeals held that since these sections of the Revenue Act authorized the Commissioner in his discretion to amend regulations without retroactive effect that the inference was to be drawn that, apart from these sections, the Commissioner would have been required upon amending his regulations to do so retroactively in all cases. The majority of the Circuit

Court of Appeals reasoned that the enactment of these Sections

> "shows that the Regulations of the Commissioner are to be regarded as tentative for the reason that amendments are retroactive unless stated to be otherwise."

Both the majority of the Circuit Court of Appeals and the dissenting judge, we believe, recognize that Article 1599 (2) was of such character as to preclude retroactive amendment under the decision of this Court in *Arizona Grocery Company* v. *Atchison, Topeka & Santa Fe Ry. Co.*, 284 U. S. 370, unless Congress had authorized the retroactive amendment. The majority of the Circuit Court of Appeals found that such authority was to be implied from Sections 1008 (a) of the Revenue Act of 1924 and Section 1108 (a) of the Revenue Act of 1926. The dissenting judge was of opinion that the discretion vested in the Commissioner by Sections 1008 (a) and 1108 (a) to apply without retroactive effect amendments to interpretative regulations afforded no basis for inferring discretion to apply with retroactive effect amendments to regulations legislative in character.

The interpretation given these sections by the dissenting judge is, it is submitted, fully supported by the Reports of the Committee of Congress. As was said by the Ways and Means Committee with reference to Section 1314 of the 1921 Revenue Bill,

> "This would facilitate the administration of the internal revenue laws, in that it would make it unnecessary to reopen thousands of settled cases." (H. Rep. No. 350, 67th Cong. 1st Sess. pp. 15, 16.)

In its report upon the Revenue Bill of 1928, the Senate Committee on Finance explaining Section 605 said that

> "The policy of this provision is highly desirable, and in view of the fact that the Bureau of Internal Revenue

> is now comparatively free from the congestion of cases from the war years, it is believed that this policy may now be extended to cases where the new regulation or Treasury decision is occasioned or required by a court decision." (S. Rep. No. 960, 70th Cong., 1st Sess. p. 40.)

Probably the clearest explanation of the purpose of these sections of the Revenue Acts is to be found in the identical statements in the House and Senate Reports and Section 506 of the Revenue Act of 1934, that

> "Regulations, Treasury Decisions, and rulings which are merely interpretive of the statute will normally have a universal application, but in some cases the applications of regulations, Treasury Decisions, and rulings to past transactions which have been closed by taxpayers in reliance upon existing practice, will work such inequitable results that it is believed desirable to lodge in the Treasury Department the power to avoid these results by applying certain regulations, Treasury Decisions, and rulings with prospective effect only." (H. Rep. No. 704, p. 38, and S. Rep. No. 558, 73rd Cong., 2d Sess.)

The reports accompanying the 1934 legislation would seem particularly to recognize that only certain of the regulations promulgated by the Commissioner are "interpretive of the statute" and that only as to such regulations was it necessary to vest in the Commissioner authority to amend without retroactive effect. The amendment of regulations, legislative in character, would not, unless provided by law, have any retroactive effect, and it was therefore unnecessary for Congress to provide that with respect to such regulations the Commissioner might make with prospective effect only.

The purpose of these sections of the Revenue Acts as disclosed by the Committee reports, was to relieve the

Commissioner, upon revising an earlier interpretation of the Acts, from the necessity of applying the new interpretation to cases previously disposed of by him under his former ruling. They were intended to avoid the congestion of proceedings before the Commissioner which would have followed from a reexamination of all pending cases on the basis of the amended regulation.

It would seem strange that the enactment of legislation intended to save taxpayers from necessarily retroactive application of interpretive regulations should be held to indicate that the Commissioner may make all amendments retroactively without regard to whether the regulation amended was interpretive or legislative in character.

C.

The basis for measuring the loss to petitioners' affiliate from the sale of the stock of Artemas Ward, Inc., is to be determined under Article 1599(2) as originally promulgated.

The majority of the Circuit Court of Appeals support their decision that Article 1599 (2) as amended is determinative by reference to the decision of this Court in *Great Northern Railway Co.* v. *Sunburst Oil & Refining Co.*, 287 U. S. 358, and to the decision of the Circuit Court of Appeals for the Third Circuit, in *Titsworth* v. *Commissioner of Internal Revenue*, 73 F. (2d) 385. Neither decision, the petitioners claim, is applicable.

In the *Sunburst Oil & Refining Co.* case, this Court held that no constitutional right was violated by the Montana Railroad Commission Act which, as construed by the State supreme court, empowered the Board of Railroad Commissioners to declare provisional rates and thereafter to award

damages to a shipper upon finding that the rates so fixed were unreasonable. This Court said:

> "*Arizona Grocery Co.* v. *Atchison, T. & S. F. Ry. Co.*, 284 U. S. 370, holds nothing to the contrary. This Court in disposing of that case was not dealing with any question of constitutional law. It was construing a Federal statute. Congress had delegated to the Interstate Commerce Commission the power to fix rates and to revoke them. The holding was that the grant of power to revoke did not include by fair intendment a power to invalidate by relation the rates established in the past. The opinion of the court does not speak of the constitution, but plants itself upon the statute, and from that source and no other derives its energy." (278 U. S. at pp. 362, 363.)*

Similarly, Congress under Section 204 (a) (9) delegated to the Commissioner of Internal Revenue, the legislative authority to promulgate regulations necessary to complete the law with respect to the apportionment of the basis of stocks received or retained in a reorganization effected in accordance with Section 203 (c).

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* In the *Sunburst Oil & Refining Co.* case, the Montana Supreme Court held that it would follow its dictum in the earlier case of *Doney* v. *Northern Pacific Railway Co.*, 60 Mont. 209, 199 Pac. 432, since shippers in reliance on that decision might have delayed challenging rates by the Commission. It recognized, however, that the construction it had previously given the statute in the *Doney* case was not in harmony with the interpretation given by this Court to the Transportation Act in *Arizona Grocery Co.* v. *Atchison, Topeka & Santa Fe Railway Co., supra,* nor with the construction other State courts had given to railroad commission statutes. The Supreme Court of Montana held, therefore, that while the rule laid down in the *Doney* decision would be adhered to in cases arising out of shipments made prior to the decision in the instant case, it would not be applied to subsequent shipments.

There is no reason to believe that the power thus vested in the Commissioner "by fair intendment" vested in him the power retroactively to amend his legislative regulations. Authority for such unusual and startling power either by an administrative body or an administrative officer, unless found to have been expressly granted by Congress, should be denied.

In *Titsworth* v. *Commissioner of Internal Revenue*, *supra*, the Circuit Court of Appeals for the Third Circuit in sustaining the Commissioner of Internal Revenue found it unnecessary to determine whether the original regulation if reasonable in its application might have been amended retroactively. The court found that the later amendment was justified either because the original regulation was unreasonable in its application to the situation, or that the later amendment was simply interpretive of the original regulation. The court said:

> "Section 113 of the Revenue Act of 1928 (26 U. S. C. A. Sec. 2113) requires the Commissioner to set up rules to determine gain from the sale of stock acquired in tax-free distributions. It provides that the basis shall be apportioned, under regulations, between such stock and the stock distributed. The resulting regulations are more than an administrative understanding or opinion of the law. If they are reasonable, they must be a declaration of the law under the authority given by Congress. The regulations as amended do not impose a tax liability on a transaction already completed. The tax liability arises under section 113 (a) (9), and that statute imposes upon the Commissioner the duty of providing the means of computing the tax. Whether Regulation 74 was defective in not providing a proper method of spreading the basis of cost or not clear in defining the scope of its

application, we see no sound reason why the error should not be corrected.*

In the present case, it is agreed that Article 1599 (2) as originally promulgated was applicable to the reorganization of Artemas Ward, Inc., the New York corporation. The issue is whether Article 1599 (2) may be retroactively changed. Unlike the situation in the *Titsworth* case, Article 1599 (2) if applied in its original form would not effect an unreasonable result; on the contrary the application of the amended regulation would.

Under Article 1599 (2) as originally promulgated, petitioners' affiliate United Brokerage Company apportioned to the stock of the New York corporation such part of the original cost to it of the stock as to permit realization of the actual loss of $2,167,785.56 (*supra*, p. 4) on selling the stock. Under the amended regulation the deductible loss allowed is only $495,696.76 (R. 39, 40).

In all fairness United Brokerage Company should not now be held to the regulations as amended more than two years after the transactions occurred. For if the Commissioner had promulgated in the first instance the regulation he seeks to effect retroactively, the United Brokerage Company could have consummated the reorganization so as to have permitted it to realize upon the subsequent sale of the stock of the New York corporation substantially all of its actual loss. A consideration of the facts will easily and convincingly demonstrate this.

---

* Section 113 (a) (9) of the Revenue Act of 1928 is a reenactment of Section 204 (a) (9) of the 1924 and 1926 Acts. Article 600 of Regulations 74 promulgated thereunder was identical with the unamended Article 1599 of Regulations 65 and 69. Its amendment was effected by Treasury decision 4274, November 13, 1929, which as previously indicated (*supra*, pp. 5-6), amended in like manner Article 1599 of Regulations 65 and 69.

At the time of the reorganization, the fair value of the net assets of the New York corporation amounted to $1,246,920.07 (R. 37). To have transferred to the new corporation net assets of the value of $50,000 would have resulted in the creation of an amply solvent corporation.*

Upon the transfer to the new corporation of net assets of $50,000, its stock would have had a value of four per cent of the total value of the stocks of the old and new corporations. Immediately after the reorganization the New York corporation would have had net assets of $1,196,920.07. Applying the regulations, as amended by the Commissioner more than two years later, the basis of the stock of the New York corporation for the purpose of determining the gain or loss upon its sale would have been 96 per cent of the $3,414,345.63, cost, or $3,167,785.56

United Brokerage Company could then, as in fact it actually did, have caused to be distributed to it all but $50,000 of the assets of the New York corporation. Since the latter corporation had sustained such an enormous loss during the short period which its stock had been owned by the United Brokerage Company, this distribution would have been non-taxable under Sections 201(b) and 201(h) of the Revenue Act of 1926.†

Thereafter, it may be assumed that, as it actually did, United Brokerage Company sold the stock of the New York corporation for $49,640. The result would have been the

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*Although not disclosed by the record, and hence not binding upon the Commissioner, the United Brokerage Company at the time of the reorganization, estimated that net assets of $30,000 would be ample to enable the new corporation to do business.

† These were reenactments of those sections of the Revenue Act of 1924, with the exception that 201(g) of the 1924 Act was renumbered 201(h) in the 1926 Act.

realization by United Brokerage Company of a deductible loss of $2,031,212.09 (only $136,573.47 less than the actual loss) as compared with the deductible loss of $495,696.76 to which the Commissioner now seeks to restrict the company.

We repeat that the petitioners are not in the position of tax evaders. It was to the petitioners' affiliate, the United Brokerage Company, a matter of indifference in what proportion the assets of the New York corporation, whose stock it wholly owned, should be distributed between the New York and Delaware corporations under the plan of reorganization. It has been misled by the rule prescribed by the Commissioner acting in a legislative capacity. His attempt retroactively to amend such a regulation is without precedent and we believe that the petitioners cannot fairly be penalized by permitting the exercise of such an authority for which no warrant is found in any Act of Congress.

Conclusion.

WHEREFORE, the petitioners respectfully submit that these are cases in which writs of certiorari should be issued to review the decisions of the Circuit Court of Appeals.

LAURENCE GRAVES,
Attorney for Petitioner.

July 9, 1935.

SAMUEL H. KAUFMAN,
EMIL WEITZNER,
Of Counsel.

APPENDIX.

Revenue Act of 1924, c. 234, 43 Stat. 254, 256, 259 and Revenue Act of 1926, c. 27, 44 Stat. 13, 14, 15:

Sec. 201. Distributions by Corporations.

(d) If any distribution (not in partial or complete liquidation) made by a corporation to its shareholders is not out of increase in value of property accrued before March 1, 1913, and is not out of earnings or profits, then the amount of such distribution shall be applied against and reduce the basis of the stock provided in section 204, and if in excess of such basis, such excess shall be taxable in the same manner as a gain from the sale or exchange of property. The provisions of this paragraph shall also apply to distributions from depletion reserves based on the discovery value of mines.

* * * * * * *

(g) As used in this section the term "amounts distributed in partial liquidation" means a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock.

* * * * * * *

Sec. 203. Recognition of Gain or Loss from Sales or Exchanges.

(c) If there is distributed, in pursuance of a plan of reorganization, to a shareholder in a corporation a party to the reorganization, stock or securities in such corporation or in another corporation a party to the reorganization, without the surrender by such shareholder of stock or securities in such a corporation, no gain to the distributee from the receipt of such stock or securities shall be recognized.

Sec. 204. Basis for Determining Gain or Loss, Depletion, and Depreciation.

(a) The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; except that—

* * * * * * *

(9) If the property consists of stock or securities distributed after December 31, 1923, to a taxpayer in connection with a transaction described in subdivision (c) of section 203, the basis in the case of the stock in respect of which the distribution was made shall be apportioned, under rules and regulations prescribed by the Commissioner with the approval of the Secretary, between such stock and the stock or securities distributed.

Revenue Act of 1921, c. 136, 42 Stat. 314;

Sec. 1314. Retroactive Regulations.

That in case a regulation or Treasury decision relating to the internal-revenue laws made by the Commissioner or the Secretary, or by the Commissioner with the approval of the Secretary, is reversed by a subsequent regulation or Treasury decision, and such reversal is not immediately occasioned or required by a decision of a court of competent jurisdiction, such subsequent regulation or Treasury decision may, in the discretion of the Commissioner, with the approval of the Secretary, be applied without retroactive effect.

Revenue Act of 1924, c. 234, 43 Stat. 341 and Revenue Act of 1926, c. 27, 44 Stat. 114;

Sec. 1008.* Retroactive Regulations.

(a) In case a regulation or Treasury decision relating to the internal-revenue laws, made by the Commissioner or the Secretary, or by the Commissioner with the approval of the Secretary, is reversed by a subsequent regulation or

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* Section 1008 of the Revenue Act of 1924 became Section 1108 of the Act of 1926 without further change.

Treasury decision, and such reversal is not immediately occasioned or required by a decision of a court of competent jurisdiction, such subsequent regulation or Treasury decision may, in the discretion of the Commissioner, with the approval of the Secretary, be applied without retroactive effect.

Revenue Act of 1928, c. 852, 45 Stat. 874.

Sec. 605. Retroactive Effect of Regulations or Treasury Decisions.

(a) In case a regulation or Treasury decision relating to the internal-revenue laws is amended by a subsequent regulation or Treasury decision, made by the Secretary or by the Commissioner with the approval of the Secretary, such subsequent regulation or Treasury decision may, with the approval of the Secretary, be applied without retroactive effect.

Revenue Act of 1934, c. 277, 48 Stat. 757:

Sec. 506. Retroactive Effect of Regulations or Treasury Decisions.

(a) The Secretary, or the Commissioner with the approval of the Secretary, may prescribe the extent, if any, to which any ruling, regulation, or Treasury Decision, relating to the internal revenue laws, shall be applied without retroactive effect.

Regulations 65, Article 1599 (subdivisions 1 and 2), promulgated October 6, 1924:

Art. 1599. Dividend stock.—In the case of stock or securities acquired by a stockholder after December 31, 1923, in connection with a transaction described in article 1576, the basis in the case of the stock in respect of which the distribution was made shall be apportioned between such stock and the stock or securities distributed to the stockholder. The basis for the old and new shares shall be determined in accordance with the following rules:

(1) Where the stock issued as a dividend is all of substantially the same character or preference as the stock upon which the dividend is paid, the basis of each share will be the quotient of the cost or other basis of the old shares of the stock divided by the total number of the old and new shares.

(2) Where the stock issued as a dividend is in whole or in part of a character or preference materially different from the stock upon which the dividend is paid, the cost or other basis of the old shares of stock shall be divided between such old stock and the new stock in proportion, as nearly as may be, to the respective values of each class of stock, old and new, at the time the new shares of stock are issued, and the basis of each share of stock will be the quotient of the cost or other basis of the class with which such share belongs, divided by the number of shares in the class. The portion of the cost or other basis of the old shares of stock to be attributed to the shares of new preferred stock shall in no case exceed the fair market value of such shares as of the time of their issuance.

Regulations 69, Article 1599 (subdivisions 1 and 2), promulgated August 28, 1926:

Art. 1599. Stock or securities distributed in reorganization.—In the case of stock or securities acquired by a shareholder after December 31, 1923, in connection with a transaction described in section 203(c) and article 1576, the basis in the case of the stock in respect of which the distribution was made shall be apportioned between such stock and the stock or securities distributed to the shareholder. The basis for the old and new shares shall be determined in accordance with the following rules:

(1) Where the stock distributed in reorganization is all of substantially the same character or preference as the stock in respect of which the distribution is made, the basis of each will be the quotient of the cost or other basis of the old shares of stock divided by the total number of the old and new shares.

(2) Where the stock distributed in reorganization is in whole or in part of a character or preference materially different from the stock in respect of which the distribution is made, the cost or other basis of the old shares of stock shall be divided between such old stock and the new stock in proportion, as nearly as may be, to the respective values of each class of stock, old and new, at the time the new shares of stock are distributed, and the basis of each share of stock will be the quotient of the cost or other basis of the class with which such share belongs, divided by the number of shares in the class. The portion of the cost or other basis of the old shares of stock to be attributed to the shares of new stock shall in no case exceed the fair market value of such shares as of the time of their distribution.

Treasury Decision 4144, promulgated April 3, 1928, amending Article 1599 of Regulations 69, provided as follows:

Paragraph (2) of Article 1599 of Regulations 69 is hereby amended by striking out the last sentence thereof.

Treasury Decision 4274, promulgated November 13, 1929, amended Article 1599 of Regulations 69, as amended by Treasury Decision 4144, to read as follows (paragraphs (1) and (2):

Art. 1599. *Stock or securities distributed in reorganization*—In the case of stock or securities acquired by a shareholder after December 31, 1923, in connection with a transaction described in Section 203 (c) and Article 1576, the basis in the case of the stock in respect of which the distribution was made shall be apportioned between such stock and the stock or securities distributed to the shareholder. The basis for the old shares and the new shares or securities shall be determined in accordance with the following rules:

(1) Where the stock distributed in reorganization consists solely of stock in the distributing corporation and is all of substantially the same character and preference as

the stock in respect of which the distribution is made, the basis of each share will be the quotient of the cost or other basis of the old shares of stock divided by the total number of the old and new shares.

(2) Where the stock distributed in reorganization is in whole or in part stock in a corporation a party to the reorganization other than the distributing corporation, or where the stock distributed in reorganization is in whole or in part stock of a character or preference materially different from the stock in respect of which the distribution is made, or where the distribution consists wholly or partly of securities other than stock, the cost or other basis of the stock in respect of which the distribution is made shall be apportioned between such stock and the stock or securities distributed in proportion, as nearly as may be, to the respective values of each class of stock or security, old and new, at the time of such distribution, and the basis of each share of stock or unit of security will be the quotient of the cost or other basis of the class of stock or security with which such share or unit belongs, divided by the number of shares or units in the class. Within the meaning of the foregoing provision, securities are different in class from stocks, stocks or securities in one corporation are different in class from stocks or securities in another corporation, and, in general, any material difference in character or preference or terms sufficient to distinguish one stock or security from another stock or security so that different values may properly be assigned thereto, will constitute a difference in class.

Article 1599 of Regulations 65 was similarly amended by this Treasury Decision.

Revenue Bill of 1921.

House Report No. 350, Ways and Means Committee, 67th Congress, 1st Session, pp. 15, 16.

Title X.—Administrative Provisions.

* * * * * * *

Section 1002* would permit the Treasury Department to apply without retroactive effect a new regulation or Treasury decision reversing a prior regulation or Treasury decision, unless such reversal is occasioned or required by a decision of a court of competent jurisdiction. This would facilitate the administration of the internal-revenue laws in that it would make it unnecessary to reopen thousands of settled cases.

Revenue Bill of 1928.

Senate Report No. 960, Committee on Finance, 70th Congress, 1st Session, p. 40.

Sec. 605. Retroactive Regulations.

Section 1108 (a) of the revenue act of 1926 provides that where a regulation or Treasury decision is reversed by a subsequent regulation or Treasury decision, the subsequent decision may be applied without retroactive effect if the reversal is not immediately occasioned or required by a court decision. The policy of this provision is highly desirable, and in view of the fact that the Bureau of Internal Revenue is now comparatively free from the congestion of cases from the war years, it is believed that this policy may now be extended to cases where the new regulation or Treasury decision is occasioned or required by a court

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*House Report 350 accompanied H. R. 8245. As indicated, Section 1002 of the Bill became, without further change, Section 1314 of the Revenue Act of 1921. See Senate Document No. 73, 67th Congress, 1st Session, p. 270.

decision. Fundamentally there is no difference in the two cases which can justify the restrictions in Section 1108 (a) of the 1926 act. Accordingly, these restrictions have been removed in Section 605 of the bill. It is believed that this amendment will prove a substantial step forward in the simplification of the administration of the internal revenue laws, especially the income tax.

Revenue Bill of 1934.

House Report No. 704, Ways and Means Committee, 73d Congress, 2d Session, p. 38.

Section 506. Retroactivity of rulings: This section amends Section 1108(a) of the Revenue Act of 1926, as amended, so as to permit the Secretary, or the Commissioner with the approval of the Secretary, to prescribe the extent, if any, to which any regulation, Treasury Decision, or ruling relating to internal revenue taxes shall be applied without retroactive effect. The amendment extends the right granted by existing law to the Treasury Department to give regulations and Treasury Decisions amending prior regulations or Treasury Decisions prospective effect only, by allowing the Secretary, or the Commissioner with the approval of the Secretary, to prescribe the exact extent to which any regulation or Treasury Decision, whether or not it amends a prior regulation or Treasury Decision, will be applied without retroactive effect. The amendment furthermore permits internal revenue rulings as well as regulations or Treasury Decisions to be applied without retroactive effect. Regulations, Treasury Decisions, and rulings which are merely interpretive of the statute will normally have a universal application, but in some cases the applications of regulations, Treasury Decisions, and rulings to past transactions which have been closed by taxpayers in reliance upon existing practice, will work such inequitable results that it is believed desirable to lodge in the Treasury Department the power to avoid these results by applying certain regulations, Treasury Decisions, and rulings with prospective effect only.

Revenue Bill of 1934.

Senate Report No. 558, Committee on Finance, 73d Congress, 2d Session, p. 48.

Section 506. Retroactivity of Rulings.

This section amends Section 1108(a) of the Revenue Act of 1926, as amended, so as to permit the Secretary to prescribe the extent, if any, to which any regulation, Treasury Decision, or ruling relating to internal-revenue taxes shall be applied without retroactive effect. The amendment extends the right granted by existing law to the Treasury Department to give regulations and Treasury Decisions amending prior regulations or Treasury Decisions prospective effect only, by allowing the Secretary, or the Commissioner with the approval of the Secretary, to prescribe the exact extent to which any regulation or Treasury Decision, whether or not it amends a prior regulation or Treasury Decision, will be applied without retroactive effect. The amendment furthermore permits internal-revenue rulings as well as regulations or Treasury Decisions to be applied without retroactive effect. Regulations, Treasury Decisions, and rulings which are merely interpretive of the statute, will normally have a universal application, but in some cases the application of regulations, Treasury Decisions, and rulings to past transactions which have been closed by taxpayers in reliance upon existing practice, will work such inequitable results that it is believed desirable to lodge in the Treasury Department the power to avoid these results by applying certain regulations, Treasury Decisions, and rulings with prospective effect only. Your committee made only clerical changes in this section of the House bill.

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Supreme Court of the United States

OCTOBER TERM, 1935.

No. 226

MANHATTAN GENERAL EQUIPMENT COMPANY,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

No. 227

COLLIER SERVICE CORPORATION, FORMERLY BROADWAY SUBWAY ADVERTISING CO., INC.,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

On Writs of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

BRIEF FOR THE PETITIONERS.

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Supreme Court of the United States

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No. 226

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Petitioner,

vs.

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Respondent.

ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR THE PETITIONERS.

Opinions Below.

The opinion in the United States Board of Tax Appeals is reported in *Manhattan General Equipment Co.* v. *Commissioner of Internal Revenue,* 29 B.T.A. 395 (R., 27); the opinion of the Circuit Court of Appeals for the Second Circuit is reported in *Manhattan General Equipment Co.* v. *The Commissioner of Internal Revenue,* 76 F. (2d) 892 (R., 45).

Jurisdiction.

The date of the judgment of the Circuit Court of Appeals sought to be reviewed is April 22, 1935 (R., 60). On May 22, 1935, the Circuit Court of Appeals denied petitions for rehearing, without opinion (R., 64). The petition for writs of certiorari was filed July 8, 1935, and was granted October 14, 1935 (R., 67). This Court has jurisdiction to review the judgments below under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925, 43 Stat. 938.

Statutes and Regulations Involved.

These are set forth in the Appendix, *infra*, pp. 21-30.

Statement of the Cases.

The cases were submitted upon an agreed statement of facts (R., 18-27), which may be summarized as follows:*

Each of the petitioners was, during the years 1925 and 1926, one of a group of affiliated corporations, the gross income and deductions of which were included in consolidated income tax returns filed by the United Brokerage Company (R., 20).

On June 30, 1925, United Brokerage Company acquired at a cost of $3,414,345.63 the capital stock of Artemas Ward, Inc., a New York corporation, consisting of 4,964 shares of stock (R., 23). One of the assets of Artemas Ward, Inc., was a contract with the Interborough Rapid Transit Company controlling advertising and vending privileges in subways and elevated railways in the City of New York (R., 22, 23). This contract, which by its terms was to continue to December 31, 1928 (R., 22),

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*The cases arise upon identical records, were argued together in the Circuit Court of Appeals and disposed of by that Court in a single opinion. They were presented to this Court upon a single petition.

was cancelled by the Transit Commission of the State of New York on November 1, 1925 (R., 23).**

On December 31, 1925, Artemas Ward, Inc., had net assets of a fair value of $1,246,920.07 (R., 24). On that date Artemas Ward, Inc., in pursuance of a plan of reorganization, transferred assets, subject to liabilities, having a net value of $961,952.86 to Artemas Ward, Inc., a Delaware corporation, in exchange for 100 shares of the stock of the Delaware corporation. On the same day, but after the transfer, Artemas Ward, Inc., the New York corporation, pursuant to the plan of reorganization distributed to United Brokerage Company the 100 shares of stock of the Delaware corporation together with accounts receivable amounting to $234,967.21. After this distribution the assets of Artemas Ward, Inc., the New York corporation, consisted of $50,000 cash (R., 24).

In December, 1926, United Brokerage Company sold to an outside party for $49,640 the 4,964 shares of the stock of Artemas Ward, Inc., the New York corporation (R., 24, 25).

**For the year 1925 United Brokerage Company claimed as a loss to Artemas Ward, Inc., by reason of the cancellation of the Interborough contract, the difference between the March 1, 1913, value of the contract and deductions theretofore allowed Artemas Ward, Inc., in its tax returns for 1922, 1923 and 1924, on account of the exhaustion of the March 1, 1913, value of the contract. The Commissioner of Internal Revenue disallowed the deduction sought for 1925. His decision was affirmed by the Board of Tax Appeals, and the latter affirmed by the Circuit Court of Appeals. *The petitioners do not seek review of that determination. The sole issue presented concerns the tax for the next year, 1926.*

Since, however, the question of the 1925 taxes is disposed of in the opinion of the Circuit Court of Appeals, the following brief statement of the issue as to the 1925 tax may help to delimit the present question as to the 1926 tax: On March 13, 1922, Artemas Ward, an individual, transferred certain assets, including the Interbor-

To summarize:

United Brokerage Company paid for the stock of Artemas Ward, Inc., the New York corporation (R., 23)		$3,414,345.63
By sale or other disposition, it received for its investment an aggregate of ..... made up as follows (R., 24, 25):		$1,246,560.07
(a) transfer to it of stock of Artemas Ward, Inc., the Delaware corporation, having a value when received of	$961,952.86	
(b) transfer to it of accounts receivable of Artemas Ward, Inc., the New York corporation, aggregating...	234,967.21	
(c) receipt from the sale of the stock of Artemas Ward, Inc., the New York corporation	49,640.00	
Thus, United Brokerage Company suffered an actual loss upon its investment of..		$2,167,785.56

ough contract, to Artemas Ward, Inc., in exchange for the latter's entire capital stock. Prior to that time Artemas Ward had been allowed in computing his net income to deduct certain amounts on account of the exhaustion of the March 1, 1913, value of the Interborough contract. These deductions, together with the deductions subsequently allowed to Artemas Ward, Inc., more than equalled the March 1, 1913, value of the contract. The Commissioner of Internal Revenue ruled that the acquisition of the contract by Artemas Ward, Inc., having been a nontaxable transaction, the deductions allowed to the individual and to the corporation were both to be considered in determining the unexhausted basis of the contract to Artemas Ward, Inc.

Upon the basis of these transactions the petitioners claim that a deduction of $2,167,785.56 should properly be allowed to United Brokerage Company for 1926. The Commissioner of Internal Revenue in re-computing the tax for 1926 allowed a deductible loss of only $495,696.76 and determined deficiencies for 1926 accordingly.

It is not questioned that the reorganization when consummated was a non-taxable transaction under the provisions of Section 203 (c) of the Revenue Act of 1924, which section was re-enacted into the Revenue Act of 1926 without change. The only issue in the case relates to the basis to be given to the stock of Artemas Ward, Inc., the New York corporation, in December, 1926, when it was sold by the United Brokerage Company to an outside party.

Section 204 (a) (9) of the Revenue Act of 1926, a reenactment without change of that section of the Revenue Act of 1924, provides that for the purpose of determining the basis of the old and the new stocks in such a reorganization as was here consummated, the cost of the old stock shall be apportioned between the old and new stocks "under rules and regulations prescribed by the Commissioner with the approval of the Secretary." Pursuant to such authority, the Commissioner on October 6, 1924, promulgated Article 1599(2) of Regulations 65 prescribing the basis of apportionment applicable to reorganizations under Section 204(a) (9) of the Revenue Act of 1924. Article 1599(2) was again promulgated with immaterial changes on August 28, 1926, under Regulations 69 issued pursuant to the Revenue Act of 1926.

Under Article 1599(2) as thus promulgated the cost of the stock of the old corporation was to be apportioned be-

tween its stock and the stock of the new corporation in the ratio of the value, upon the reorganization, of the old and new stocks, but with the proviso that in no event should the cost to be attributed to the new stock be greater than the value of the new stock at the time of the reorganization. *Under this formula the cost to be attributed to the 100 shares of the stock of Artemas Ward, Inc., the Delaware corporation, was $961,952.86, its actual value.*

On April 3, 1928, the Commissioner promulgated Treasury Decision 4144, which amended Article 1599(2) of Regulations 69 so as to eliminate the provision that the cost to be apportioned to the new stock should not exceed its value at the time of the reorganization. On November 13, 1929, the Commissioner of Internal Revenue promulgated Treasury Decision 4274 reaffirming the 1928 amendment of Article 1599(2) and extending its application to Regulations 65.*

Applying the amended Article 1599(2) retroactively, the Commissioner redetermined the cost to be apportioned to the stock of Artemas Ward, Inc., the Delaware corporation, at $2,634,041.66 (R., 26),—an increase of $1,672,088.80. This resulted in reducing the cost apportioned to the stock of Artemas Ward, Inc., the New York corporation, to $780,303.97. Upon the readjusted basis of cost, the Commissioner determined the amount of the loss sustained by the United Brokerage Company upon the sale of the stock of the New York corporation to be $495,696.76 (R., 26), —a reduction of $1,672,088.80.

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*Decision 4274 also added certain matter, which concededly was declaratory of the interpretation previously given by the Commissioner to the unamended article, and which is immaterial here.

The Board of Tax Appeals approved the Commissioner's determination. The Circuit Court of Appeals, one of the judges dissenting, affirmed the Board of Tax Appeals and held that Article 1599(2) of the Regulations promulgated by the Commissioner pursuant to Section 204(a) (9) was tentative in character and that authority to amend the regulation retroactively was implied by Section 1008(a) of the Revenue Act of 1924 and 1108(a) of the Revenue Act of 1926. In so holding the Circuit Court of Appeals overruled the petitioners' contention that Article 1599(2) of the Regulations was legislative in character, that Section 1108(a) permitting non-retrospective amendment of interpretative regulations implies no authority to the Commissioner to amend legislative regulations retroactively, and that the Commissioner of Internal Revenue was without authority to amend and apply Article 1599(2) retroactively.

The Question Presented.

Where the Revenue Acts provide that the basis for ascertaining gain or loss with respect to stocks received or retained in a non-taxable reorganization shall be prescribed by the Commissioner of Internal Revenue under regulations to be promulgated by him,

> Is the basis governed by a regulation promulgated by the Commissioner which is in effect at the time that a plan of reorganization is consummated and at the time that property is sold, or is it governed by a regulation prescribed by an amendment promulgated more than two years subsequent to those transactions?

Specifications of Errors to Be Urged.

1. The Circuit Court of Appeals erred in holding that the loss sustained by United Brokerage Company in 1926

upon the sale of the stock of Artemas Ward, Inc., should be computed in accordance with the provisions of Article 1599(2) of Regulations 69, as amended and revised on April 3, 1928 and November 13, 1929.

2. The Circuit Court of Appeals erred in holding that authority of the Commissioner of Internal Revenue to amend retroactively the provisions of Article 1599(2) of Regulations 65 and 69 promulgated October 6, 1924, and August 28, 1926, respectively, may be implied from Section 1008(a) of the Revenue Act of 1924 and Section 1108(a) of the Revenue Act of 1926.

3. The Circuit Court of Appeals erred in failing to hold that the provisions of Article 1599(2) of Regulations 65 and 69 promulgated October 6, 1924, and August 28, 1926, respectively, were legislative in character and that the Commissioner of Internal Revenue was without power or authority to amend such provisions so as to apply retroactively to the petitioners.

4. The Circuit Court of Appeals erred in affirming the decision of the Board of Tax Appeals which sustained the Commissioner of Internal Revenue.

Summary of Argument.

The Commissioner in promulgating the regulations under authority of Section 204(a)(9), in no sense merely interpreted the law. Prior to the issuance of his regulation there was no law providing for apportioning the cost between the stock originally held and the stock distributed pursuant to the plan of reorganization. Under the decision of this Court in *Arizona Grocery Company* v. *Atchison, Topeka & Santa Fe Ry. Co.*, 284 U. S. 370, the Com-

missioner must be held to have acted in a quasi-legislative manner in promulgating Article 1599(2). Under that decision of this Court the Commissioner was, therefore, without authority to amend retroactively the regulation promulgated by him and acted upon by the petitioners. Whether or not Congress might have authorized the Commissioner to amend the regulations retroactively is not an issue in this case, since Congress has not done so. Hence the case of *Great Northern Railway Company* v. *Sunburst Oil and Refining Company,* 287 U. S. 358, upon which the majority of the Circuit Court of Appeals rested their decision, is inapplicable.

Ever since the enactment of the Revenue Act of 1924, and the continuance in subsequent acts, with minor changes, of elaborate, precise and comprehensive provisions governing the taxability upon the sale or other disposition of stock received or retained in connection with reorganizations, taxpayers and their counsel have acted and advised in reliance upon the plain propositions of Article 1599(2) promulgated under the authority of Section 204(a)(9). It was a matter of indifference to the petitioners' affiliate, the United Brokerage Company, in what proportions the assets of the New York corporation, whose stock it wholly owned, should be distributed between the New York and Delaware corporations under the plan of reorganization. If the Commissioner had promulgated in the first instance the regulation he sought to effect retroactively more than two years later, United Brokerage Company could have reduced the amount of the net assets transferred to the Delaware corporation, so that while such assets would have been more than ample for the latter's business needs, the proportion of assets transferred and retained would have been such as to permit substantially all of the loss to United Brokerage Company of $2,-

167,785.56 to be realized upon the sale of the stock of the New York corporation.*

The petitioners are not in the position of tax evaders. On the contrary, the Commissioner occupies the role of one who has prescribed a "rule of the road" entirely fair and reasonable in its application to the petitioners and their affiliates and has then sought retroactively to change his ruling. Thus, although the United Brokerage Company could have proceeded safely and properly under the amended rule, the Commissioner seeks to penalize it for not having the prescience to anticipate that he would change his ruling in the particular in which Article 1599(2) was modified.

The petitioners, therefore, maintain the following propositions:

I.—Article 1599(2) of Regulations 65 and 69 promulgated by the Commissioner of Internal Revenue on October 6, 1924, and August 28, 1926, respectively, was legislative in character; and since

II.—No implication may be drawn from Section 1008(a) of the Revenue Act of 1924 and Section 1108(a) of the Revenue Act of 1926, that the Commissioner of Internal Revenue is authorized to amend Article 1599(2) retroactively; hence

III.—The basis for measuring the loss to petitioners' affiliate from the sale of the stock of Artemas Ward, Inc., is to be determined under Article 1599(2) as originally promulgated.

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*See detailed analysis, *infra*, pp. 18, 19.

Argument.

I.

Article 1599(2) of Regulations 65 and 69 promulgated by the Commissioner of Internal Revenue on October 6, 1924, and August 28, 1926, respectively, was legislative in character.

Section 203(c) of the Revenue Acts of 1924 and 1926 provides that if there is distributed to a shareholder in a corporation a party to a reorganization, stock in such corporation or in another corporation a party to the reorganization without the surrender of the stock originally held, no gain or loss to the shareholder shall be recognized. Section 204(a)(9) of these Acts provides, that in such a case, for the purpose of determining the gain or loss from a subsequent sale or other disposition, the basis of the old stock shall be apportioned between the old and the new stocks under regulations prescribed by the Commissioner of Internal Revenue. Until such regulations are prescribed there is no law in regard to the method to be used in apportioning the basis.

When the Commissioner acting pursuant to the power delegated to him under Section 204(a)(9) promulgates Article 1599(2) he is, we believe, in no sense interpreting the Revenue Act. Article 1599(2) does not purport to state the meaning of the Revenue Act. It is declarative of the law, and quasi-legislative in nature. In promulgating Article 1599(2) the Commissioner "speaks as the legislature" and his pronouncement "has the force of a statute". *Arizona Grocery Co.* v. *Achison, Topeka & Santa Fe Railway Co.*, 284 U. S. 370, 386.

II.

No implication may be drawn from Section 1008(a) of the Revenue Act of 1924 or Section 1108(a) of the Revenue Act of 1926 that the Commissioner of Internal Revenue is authorized to amend Article 1599(2) retroactively.

Section 1108(a) of the Revenue Act of 1926, which is identical with Section 1008(a) of the Revenue Act of 1924 and Section 1314 of the Revenue Act of 1921, provides

> "In case a regulation or Treasury decision relating to the internal-revenue laws, made by the Commissioner or the Secretary, or by the Commissioner with the approval of the Secretary, is reversed by a subsequent regulation or Treasury decision, and such reversal is not immediately occasioned or required by a decision of a court of competent jurisdiction, such subsequent regulation or Treasury decision may, in the discretion of the Commissioner, with the approval of the Secretary, be applied without retroactive effect."

Under Section 605 of the Revenue Act of 1928, the Commissioner was given the same discretion without limitation as to how the change in his former ruling was occasioned. Under Section 506 of the Revenue Act of 1934, the 1928 provision was reiterated and extended to cover internal-revenue rulings as well as regulations and Treasury decisions.

The majority of the Circuit Court of Appeals held that since these sections of the Revenue Act authorized the Commissioner in his discretion to amend regulations without retroactive effect that the inference was to be drawn that, apart from these sections, the Commissioner would have been required upon amending his regulations to do so retroactively in all cases. The majority of the Circuit

Court of Appeals reasoned that the enactment of these sections

> "shows that the Regulations of the Commissioner are to be regarded as tentative for the reason that amendments are retroactive unless stated to be otherwise."

Both the majority of the Circuit Court of Appeals and the dissenting judge, we believe, recognize that Article 1599(2) was of such character as to preclude retroactive amendment under the decision of this Court in *Arizona Grocery Company* v. *Atchison, Topeka & Santa Fe Ry. Co.*, 284 U. S. 370, unless Congress had authorized the retroactive amendment. The majority of the Circuit Court of Appeals found that such authority was to be implied from Sections 1008(a) of the Revenue Act of 1924 and Section 1108(a) of the Revenue Act of 1926. The dissenting judge was of opinion that the discretion vested in the Commissioner by Sections 1008(a) and 1108(a) to apply without retroactive effect amendments to interpretative regulations afforded no basis for inferring discretion to apply with retroactive effect amendments to regulations legislative in character.

The interpretation given these sections by the dissenting judge is, it is submitted, fully supported by the Reports of the Committee of Congress. As was said by the Ways and Means Committee with reference to Section 1314 of the 1921 Revenue Bill permitting non-retroactive reversal of prior regulations and Treasury decisions,

> "This would facilitate the administration of the internal revenue laws, in that it would make it unnecessary to reopen thousands of settled cases." (H. Rep. No. 350, 67th Cong. 1st Sess., pp. 15, 16.)

In its report upon the Revenue Bill of 1928, the Senate Committee on Finance explaining Section 605 said that

> "The policy of this provision is highly desirable, and in view of the fact that the Bureau of Internal Revenue is now comparatively free from the congestion of cases from the war years, it is believed that this policy may now be extended to cases where the new regulation or Treasury decision is occasioned or required by a court decision." (S. Rep. No. 960, 70th Cong., 1st Sess., p. 40.)

Probably the clearest statement of the purpose of these sections of the Revenue Acts is to be found in the identical reports in the House and Senate Committees on Section 506 of the Revenue Act of 1934, extending the application of the earlier statutes to Treasury rulings. Both Committees said,

> "Regulations, Treasury Decisions, and rulings which are merely interpretative of the statute will normally have a universal application, but in some cases the applications of regulations, Treasury Decisions, and rulings to past transactions which have been closed by taxpayers in reliance upon existing practice, will work such inequitable results that it is believed desirable to lodge in the Treasury Department the power to avoid these results by applying certain regulations, Treasury Decisions, and rulings with prospective effect only." (H. Rep. No. 704, p. 38, and S. Rep. No. 558, 73rd Cong., 2d Sess.)

The reports accompanying the 1934 legislation would seem particularly to recognize that only certain of the regulations promulgated by the Commissioner are "interpretive of the statute" and that only as to such regulations was it necessary to vest in the Commissioner authority to amend without retroactive effect. The amendment of regulations, legislative in character, would not,

unless provided by law, have any retroactive effect, and it was therefore unnecessary for Congress to provide that with respect to such regulations the Commissioner might make with prospective effect only.

The purpose of these sections of the Revenue Acts, as disclosed by the Committee reports, was to relieve the Commissioner, upon revising an earlier interpretation of the Acts, from the necessity of applying the new interpretation to cases previously disposed of by him under his former ruling. They were intended to avoid (a) the congestion of proceedings before the Commissioner which would have followed from a re-examination of all pending cases on the basis of the amended regulation; (b) the inequitable result of reopening cases closed by taxpayers in reliance upon existing practices.

It would seem strange that the enactment of legislation intended to save taxpayers from necessarily retroactive application of interpretive regulations should be held to vest in the Commissioner the unusual power to amend retroactively regulations legislative in character and thus to subject the taxpayer for the first time to hardships no less great than those which the legislation was intended to preclude.

III.

The basis for measuring the loss to petitioners' affiliate from the sale of the stock of Artemas Ward, Inc., is to be determined under Article 1599(2) as originally promulgated.

The majority of the Circuit Court of Appeals support their decision that Article 1599(2) as amended is determinative by reference to the decision of this Court in *Great Northern Railway Co.* v. *Sunburst Oil & Refining Co.*, 287 U. S. 358, and to the decision of the Circuit Court of Appeals for the Third Circuit, in *Titsworth* v. *Commis-*

sioner of Internal Revenue, 73 F. (2d) 385. Neither decision, the petitioners claim, is applicable.

In the *Sunburst Oil & Refining Co.* case, this Court held that no constitutional right was violated by the Montana Railroad Commission Act which, as construed by the State Supreme Court, empowered the Board of Railroad Commissioners to declare provisional rates and thereafter to award damages to a shipper upon finding that the rates so fixed were unreasonable. This Court said:

> "*Arizona Grocery Co.* v. *Atchison, T. & S. F. Ry. Co.,* 284 U. S. 370, holds nothing to the contrary. This Court in disposing of that case was not dealing with any question of constitutional law. It was construing a Federal statute. Congress had delegated to the Interstate Commerce Commission the power to fix rates and to revoke them. The holding was that the grant of power to revoke did not include by fair intendment a power to invalidate by relation the rates established in the past. The opinion of the court does not speak of the constitution, but plants itself upon the statute, and from that source and no other derives its energy." (278 U. S. at pp. 362, 363.)*

*In the *Sunburst Oil & Refining Co.* case, the Montana Supreme Court held that it would follow its dictum in the earlier case of *Doney* v. *Northern Pacific Railway Co.,* 60 Mont. 209, 199 Pac. 432, since shippers in reliance on that decision might have delayed challenging rates by the Commission. It recognized, however, that the construction it had previously given the statute in the *Doney* case was not in harmony with the interpretation given by this Court to the Transportation Act in *Arizona Grocery Co.* v. *Atchison, Topeka & Santa Fe Railway Co., supra,* nor with the construction other State courts had given to railroad commission statutes. The Supreme Court of Montana held, therefore, that while the rule laid down in the *Doney* decision would be adhered to in cases arising out of shipments made prior to the decision in the instant case, it would not be applied to subsequent shipments.

Similarly, Congress under Section 204(a)(9) delegated to the Commissioner of Internal Revenue, the legislative authority to promulgate regulations necessary to complete the law with respect to the apportionment of the basis of stocks received or retained in a reorganization effected in accordance with Section 203(c).

There is no reason to believe that the power thus given the Commissioner "by fair intendment" vested in him the power retroactively to amend his legislative regulations. Authority for such unusual and startling power either by an administrative body or an administrative officer, unless found to have been expressly granted by Congress, should be denied.

In *Titsworth* v. *Commissioner of Internal Revenue, supra,* the Circuit Court of Appeals for the Third Circuit in sustaining the Commissioner of Internal Revenue found it unnecessary to determine whether the original regulation if reasonable in its application might have been amended retroactively. The court found that the later amendment was justified either because the original regulation was unreasonable in its application to the situation, or that the later amendment was simply interpretive of the original regulation. The court said:

> "Section 113 of the Revenue Act of 1928 (26 U. S. C. A. Sec. 2113) requires the Commissioner to set up rules to determine gain from the sale of stock acquired in tax-free distributions. It provides that the basis shall be apportioned, under regulations, between such stock and the stock distributed. The resulting regulations are more than an administrative understanding or opinion of the law. If they are reasonable, they must be a declaration of the law under the authority given by Congress. The regulations as amended do not impose a tax liability

on a transaction already completed. The tax liability arises under section 113(a)(9), and that statute imposes upon the Commissioner the duty of providing the means of computing the tax. Whether Regulation 74 was defective in not providing a proper method of spreading the basis of cost or not clear in defining the scope of its application, we see no sound reason why the error should not be corrected.'"*

In the present case, it is agreed that Article 1599(2) as originally promulgated was applicable to the reorganization of Artemas Ward, Inc., the New York corporation. The issue is whether Article 1599(2) may be retroactively changed. Unlike the situation in the *Titsworth* case, Article 1599(2) if applied in its original form would not effect an unreasonable result; on the contrary the application of the amended regulation would.

Under Article 1599(2) as originally promulgated, petitioners' affiliate United Brokerage Company apportioned to the stock of the New York corporation such part of the original cost to it of the stock as to permit realization of the actual loss of $2,167,785.56 (*supra*, p. 6) on selling the stock. Under the amended regulation the deductible loss allowed is only $495,696.76 (*supra*, pp. 5, 7).

In all fairness United Brokerage Company should not now be held to the regulations as amended more than two

*Section 113(a)(9) of the Revenue Act of 1928 is a re-enactment of Section 204(a)(9) of the 1924 and 1926 Acts. Article 600 of Regulations 74 promulgated thereunder was identical with the unamended Article 1599 of Regulations 65 and 69. Its amendment was effected by Treasury decision 4274, November 13, 1929, which as previously indicated (*supra*, p. 6), amended in like manner Article 1599 of Regulations 65 and 69.

years after the transactions occurred. For if the Commissioner had promulgated in the first instance the regulation he seeks to effect retroactively, the United Brokerage Company could have consummated the reorganization so as to have permitted it to realize upon the subsequent sale of the stock of the New York corporation substantially all of its actual loss. A consideration of the facts will easily and convincingly demonstrate this.

At the time of the reorganization, the fair value of the net assets of the New York corporation amounted to $1,246,920.07 (R., 24). To have transferred to the new corporation net assets of the value of $50,000 would have resulted in the creation of an amply solvent corporation.*

Upon the transfer to the new corporation of net assets of $50,000, its stock would have had a value of four per cent. of the total value of the stocks of the old and new corporations. Immediately after the reorganization the New York corporation would have had net assets of $1,196,920.07. Applying the regulations, *as amended by the Commissioner more than two years later,* the basis of the stock of the New York corporation for the purpose of determining the gain or loss upon its sale would have been 96 per cent. of the $3,414,345.63, cost, or $3,167,785.56.

United Brokerage Company could then, as in fact it actually did, have caused to be distributed to it all but $50,000 of the assets of the New York corporation. Since the latter corporation had sustained such an enormous loss during the short period which its stock had been owned by the United Brokerage Company, this distribution

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*Although not disclosed by the record, and hence not binding upon the Commissioner, the United Brokerage Company at the time of the reorganization, estimated that net assets of $30,000 would be ample to enable the new corporation to do business.

would have been non-taxable under Sections 201(b) and 201(h) of the Revenue Act of 1926.*

Thereafter, it may be assumed that, as it actually did, United Brokerage Company sold the stock of the New York corporation for $49,640. The result would have been the realization by United Brokerage Company of a deductible loss of $2,031,212.09 (only $136,573.47 less than the actual loss) as compared with the deductible loss of $495,696.76 to which the Commissioner now seeks to restrict the company.

We repeat that the petitioners are not in the position of tax evaders. It was to the petitioners' affiliate, the United Brokerage Company, a matter of indifference in what proportion the assets of the New York corporation, whose stock it wholly owned, should be distributed between the New York and Delaware corporations under the plan of reorganization. It has been misled by the rule prescribed by the Commissioner acting in a legislative capacity. His attempt retroactively to amend such a regulation is without precedent and we believe that the petitioners cannot fairly be penalized by permitting the exercise of such an authority for which no warrant is found in any Act of Congress.

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*These were re-enactments of those sections of the Revenue Act of 1924, with the exception that 201(g) of the 1924 Act was renumbered 201(h) in the 1926 Act.

Conclusion.

WHEREFORE, petitioners respectfully submit that the judgments of the Circuit Court of Appeals for the Second Circuit should be reversed by this Honorable Court, and your petitioners should have such other and further relief in the premises as to this Honorable Court may seem meet and just.

November 29, 1935.

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APPENDIX.

Revenue Act of 1924, c. 234, 43 Stat. 254, 256, 259 and Revenue Act of 126, c. 27, 44 Stat. 13, 14, 15:

Sec. 201. *Distributions by Corporations.*

(d) If any distribution (not in partial or complete liquidation) made by a corporation to its shareholders is not out of increase in value of property accrued before March 1, 1913, and is not out of earnings or profits, then the amount of such distribution shall be applied against and reduce the basis of the stock provided in section 204, and if in excess of such basis, such excess shall be taxable in the same manner as a gain from the sale or exchange of property. The provisions of this paragraph shall also apply to distributions from depletion reserves based on the discovery value of mines.

* * * * * * * *

(g) As used in this section the term "amounts distributed in partial liquidation" means a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock.

* * * * * * * *

Sec. 203. Recognition of Gain or Loss from Sales or Exchanges.

(c) If there is distributed, in pursuance of a plan of reorganization, to a shareholder in a corporation a party to the reorganization, stock or securities in such corporation or in another corporation a party to the reorganization, without the surrender by such shareholder of stock or securities in such a corporation, no gain to the distributee from the receipt of such stock or securities shall be recognized.

Sec. 204. Basis for Determining Gain or Loss, Depletion, and Depreciation.

(a) The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; except that——

* * * * * * * *

(9) If the property consists of stock or securities distributed after December 31, 1923, to a taxpayer in connection with a transaction described in subdivision (c) of section 203, the basis in the case of the stock in respect of which the distribution was made shall be apportioned, under rules and regulations prescribed by the Commissioner with the approval of the Secretary between such stock and the stock or securities distributed.

Revenue Act of 1921, c. 136, 42 Stat. 314:

Sec. 1314. *Retroactive Regulations.*

That in case a regulation or Treasury decision relating to the internal-revenue laws made by the Commissioner or the Secretary, or by the Commissioner with the approval of the Secretary, is reversed by a subsequent regulation or Treasury decision, and such reversal is not immediately occasioned or required by a decision of a court of competent jurisdiction, such subsequent regulation or Treasury decision may, in the discretion of the Commissioner, with the approval of the Secretary, be applied without retroactive effect.

Revenue Act of 1924, c. 234, 43 Stat. 341 and Revenue Act of 1926, c. 27, 44 Stat. 114:

Sec. 1008.† *Retroactive Regulations.*

(a) In case a regulation or Treasury decision relating to the internal-revenue laws, made by the Commissioner or the Secretary, or by the Commissioner with the approval of the Secretary, is reversed by a subsequent regulation or Treasury decision, and such reversal is not immediately occasioned or required by a decision of a court of competent jurisdiction, such subsequent regulation or Treasury decision may, in the discretion of the Commissioner, with the approval of the Secretary, be applied without retroactive effect.

Revenue Act of 1928, c. 852, 45 Stat. 874:

Sec. 605. *Retroactive Effect of Regulations or Treasury Decisions.*

(a) In case a regulation or Treasury decision relating to the internal-revenue laws is amended by a subsequent regulation or Treasury decision, made by the Secretary or by the Commissioner with the approval of the Secretary, such subsequent regulation or Treasury decision may, with the approval of the Secretary, be applied without retroactive effect.

Revenue Act of 1934, c. 277, 48 Stat. 757:

Sec. 506. *Retroactive Effect of Regulations or Treasury Decisions.*

(a) The Secretary, or the Commissioner with the approval of the Secretary, may prescribe the extent, if any, to which any ruling, regulation, or Treasury Decision, relating to the internal revenue laws, shall be applied without retroactive effect.

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†Section 1008 of the Revenue Act of 1924 became Section 1108 of the Act of 1926 without further change.

Regulations 65, Article 1599 (subdivisions 1 and 2), promulgated October 6, 1924:

Art. 1599. *Dividend Stock.*—In the case of stock or securities acquired by a stockholder after December 31, 1923, in connection with a transaction described in Article 1576, the basis in the case of the stock in respect of which the distribution was made shall be apportioned between such stock and the stock or securities distributed to the stockholder. The basis for the old and new shares shall be determined in accordance with the following rules:

(1) Where the stock issued as a dividend is all of substantially the same character or preference as the stock upon which the dividend is paid, the basis of each share will be the quotient of the cost or other basis of the old shares of the stock divided by the total number of the old and new shares.

(2) Where the stock issued as a dividend is in whole or in part of a character or preference materially different from the stock upon which the dividend is paid, the cost or other basis of the old shares of stock shall be divided between such old stock and the new stock in proportion, as nearly as may be, to the respective values of each class of stock, old and new, at the time the new shares of stock are issued, and the basis of each share of stock will be the quotient of the cost or other basis of the class with which such share belongs, divided by the number of shares in the class. The portion of the cost or other basis of the old shares of stock to be attributed to the shares of new preferred stock shall in no case exceed the fair market value of such shares as of the time of their issuance.

Regulations 69, Article 1599 (subdivisions 1 and 2), promulgated August 28, 1926:

Art. 1599. Stock or securities distributed in reorganization.—In the case of stock or securities acquired by a shareholder after December 31, 1923, in connection with a transaction described in section 203(c) and Article 1576, the basis in the case of the stock in respect of which the distribution was made shall be apportioned between such stock and the stock or securities distributed to the shareholder. The basis for the old and new shares shall be determined in accordance with the following rules:

(1) Where the stock distributed in reorganization is all of substantially the same character or preference as the stock in respect of which the distribution is made, the basis of each will be the quotient of the cost or other basis of the old shares of stock divided by the total number of the old and new shares.

(2) Where the stock distributed in reorganization is in whole or in part of a character or preference materially different from the stock in respect of which the distribution is made, the cost or other basis of the old shares of stock shall be divided between such old stock and the new stock in proportion, as nearly as may be, to the respective values of each class of stock, old and new, at the time the new shares of stock are distributed, and the basis of each share of stock will be the quotient of the cost or other basis of the class with which such share belongs, divided by the number of shares in the class. The portion of the cost or other basis of the old shares of stock to be attributed to the shares of new stock shall in no case exceed the fair market value of such shares as of the time of their distribution.

Treasury Decision 4144, promulgated April 3, 1928, amending Article 1599 of Regulations 69, provided as follows:

Paragraph (2) of Article 1599 of Regulations 69 is hereby amended by striking out the last sentence thereof.

Treasury Decision 4274, promulgated November 13, 1929, amended Article 1599 of Regulations 69, as amended by Treasury Decision 4144, to read as follows [paragraphs (1) and (2)]†:

Art. 1599. *Stock or securities distributed in reorganization*—In the case of stock or securities acquired by a shareholder after December 31, 1923, in connection with a transaction described in Section 203(c) and Article 1576, the basis in the case of the stock in respect of which the distribution was made shall be apportioned between such stock and the stock or securities distributed to the shareholder. The basis for the old shares and the new shares or securities shall be determined in accordance with the following rules:

(1) Where the stock distributed in reorganization consists solely of stock in the distributing corporation and is all of substantially the same character and preference as the stock in respect of which the distribution is made, the basis of each share will be the quotient of the cost or other basis of the old shares of stock divided by the total number of the old and new shares.

(2) Where the stock distributed in reorganization is in whole or in part stock in a corporation a party to the reorganization other than the distributing corporation, or where the stock distributed in reorganization is in whole or in part stock of a character or preference materially

†Article 1599 of Regulations 65 was similarly amended by this Treasury Decision.

different from the stock in respect of which the distribution is made, or where the distribution consists wholly or partly of securities other than stock, the cost or other basis of the stock in respect of which the distribution is made shall be apportioned between such stock and the stock or securities distributed in proportion, as nearly as may be, to the respective values of each class of stock or security, old and new, at the time of such distribution, and the basis of each share of stock or unit of security will be the quotient of the cost or other basis of the class of stock or security with which such share or unit belongs, divided by the number of shares or units in the class. Within the meaning of the foregoing provision, securities are different in class from stocks, stocks or securities in one corporation are different in class from stocks or securities in another corporation, and, in general, any material difference in character or preference or terms sufficient to distinguish one stock or security from another stock or security so that different values may properly be assigned thereto, will constitute a difference in class.

Revenue Bill of 1921.

House Report No. 350, Ways and Means Committee, 67th Congress, 1st Session, pp. 15, 16:

Title X.—Administrative Provisions.

* * * * * * * *

Section 1002† would permit the Treasury Department to apply without retroactive effect a new regulation or Treasury decision reversing a prior regulation or Treasury decision, unless such reversal is occasioned or required

†House Report 350 accompanied H. R. 8245. Section 1002 of the Bill became, without further change, Section 1314 of the Revenue Act of 1931. See Senate Document No. 73, 67th Congress, 1st Session, p. 270.

by a decision of a court of competent jurisdiction. This would facilitate the administration of the internal revenue laws in that it would make it unnecessary to reopen thousands of settled cases.

Revenue Bill of 1928.

Senate Report No. 960, Committee on Finance, 70th Congress, 1st Session, p. 40:

Sec. 605. Retroactive Regulations.

Section 1108(a) of the revenue act of 1926 provides that where a regulation or Treasury decision is reversed by a subsequent regulation or Treasury decision, the subsequent decision may be applied without retroactive effect if the reversal is not immediately occasioned or required by a court decision. The policy of this provision is highly desirable, and in view of the fact that the Bureau of Internal Revenue is now comparatively free from the congestion of cases from the war years, it is believed that this policy may now be extended to cases where the new regulation or Treasury decision is occasioned or required by a court decision. Fundamentally there is no difference in the two cases which can justify the restrictions in Section 1108(a) of the 1926 act. Accordingly, these restrictions have been removed in Section 605 of the bill. It is believed that this amendment will prove a substantial step forward in the simplification of the administration of the internal revenue laws, especially the income tax.

Revenue Bill of 1934.

House Report No. 704, Ways and Means Committee, 73d Congress, 2d Session, p. 38:

Section 506. Retroactivity of rulings: This section amends Section 1108(a) of the Revenue Act of 1926, as amended, so as to permit the Secretary, or the Commissioner with the approval of the Secretary, to prescribe the extent, if any, to which any regulation, Treasury Decision, or ruling relating to internal revenue taxes shall be applied without retroactive effect. The amendment extends the right granted by existing law to the Treasury Department to give regulations and Treasury Decisions amending prior regulations or Treasury Decisions prospective effect only, by allowing the Secretary, or the Commissioner with the approval of the Secretary, to prescribe the exact extent to which any regulation or Treasury Decision, whether or not it amends a prior regulation or Treasury Decision, will be applied without retroactive effect. The amendment furthermore permits internal revenue rulings as well as regulations or Treasury Decisions to be applied without retroactive effect. Regulations, Treasury Decisions, and rulings which are merely interpretive of the statute will normally have a universal application, but in some cases the applications of regulations, Treasury Decisions, and rulings to past transactions which have been closed by taxpayers in reliance upon existing practice, will work such inequitable results that it is believed desirable to lodge in the Treasury Department the power to avoid these results by applying certain regulations, Treasury Decisions, and rulings with prospective effect only.

Revenue Bill of 1934.

Senate Report No. 558, Committee on Finance, 73d Congress, 2d Session, p. 48:

Section 506. Retroactivity of Rulings.

This section amends Section 1108(a) of the Revenue Act of 1926, as amended, so as to permit the Secretary to prescribe the extent, if any, to which any regulation, Treasury Decision, or ruling relating to internal-revenue taxes shall be applied without retroactive effect. The amendment extends the right granted by existing law to the Treasury Department to give regulations and Treasury Decisions amending prior regulations or Treasury Decisions prospective effect only, by allowing the Secretary, or the Commissioner with the approval of the Secretary, to prescribe the exact extent to which any regulation or Treasury Decision, whether or not it amends a prior regulation or Treasury Decision, will be applied without retroactive effect. The amendment furthermore permits internal-revenue rulings as well as regulations or Treasury Decisions to be applied without retroactive effect. Regulations, Treasury Decisions, and rulings which are merely interpretive of the statute, will normally have a universal application, but in some cases the application of regulations, Treasury Decisions, and rulings to past transactions which have been closed by taxpayers in reliance upon existing practice, will work such inequitable results that it is believed desirable to lodge in the Treasury Department the power to avoid these results by applying certain regulations, Treasury Decisions, and rulings with prospective effect only. Your committee made only clerical changes in this section of the House bill.

FILE COPY

Nos. 226 and 227

In the Supreme Court of the United States

OCTOBER TERM, 1935

MANHATTAN GENERAL EQUIPMENT COMPANY, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

COLLIER SERVICE CORPORATION, FORMERLY BROADWAY SUBWAY ADVERTISING CO., INC., PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

IN PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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In the Supreme Court of the United States

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GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

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ON PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 42–52)[1] is reported in 29 B. T. A. 395. The opinion

[1] The records have been separately printed. However, the cases were consolidated before the Board of Tax Appeals (see Record in Manhattan General Equipment Company case, p. 1), and disposed of in a single opinion both in the Board of Tax Appeals and in the Circuit Court of Appeals. Unless otherwise indicated, references to the record are to the record in the Manhattan General Equipment Company case, No. 226.

of the Circuit Court of Appeals (R. 69–77) is reported in 76 F. (2d) 892.

JURISDICTION

The judgments of the Circuit Court of Appeals were entered April 22, 1935 (R. 84). A petition for rehearing was denied May 22, 1935 (R. 88). The petition for writs of certiorari was filed July 8, 1935. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Where, pursuant to a reorganization, a stockholder in 1925 receives stock in another corporation without surrender of his original shares and in 1926 sells the old shares, should the basis for measuring the gain or loss on sale be determined by apportioning the cost of the old shares between the old and the new under the method provided by Article 1599 (2) of Regulations 69 as amended subsequently to 1926, or under the method provided by that regulation as originally promulgated in 1926?

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved appear in the Appendix, *infra,* pp. 10–13.

STATEMENT

During the year 1926 the petitioners were affiliated with United Brokerage Company and a num-

ber of other corporations. They filed consolidated returns, and the Commissioner determined the proportion of the tax which should be assessed against each of them (R. 29–33).

The total capital stock (4,964 shares of common) of one of the affiliates, Artemas Ward, Inc., a New York corporation, had been acquired by United Brokerage Company at a cost of $3,414,345.63 (R. 36). On December 31, 1925, the total net assets of Artemas Ward, Inc., had a fair value of $1,246,920.07 (R. 37). On that date Artemas Ward, Inc., transferred all its assets, with the exception of cash and accounts receivable aggregating $284,967.21, to another corporation of the same name organized under the laws of Delaware. In exchange the Delaware corporation issued all its capital stock (100 shares) to the New York corporation (R. 37).

Immediately thereafter, on the same day, the New York corporation distributed to its sole stockholder, United Brokerage Company, the 100 shares of stock of the Delaware corporation, together with accounts receivable aggregating $234,967.21, thus leaving the New York corporation with net assets in the amount of $50,000 (R. 37).

In December 1926, United Brokerage Company, in two transactions, sold to an outsider all of its stock in the New York corporation for $49,640 (R. 37–38). The sole question involved in this peti-

tion relates to the method for computing the loss on that sale.[2]

Following Article 1599 (2) of Regulations 69, as amended (see Appendix, *infra*), the Commissioner computed the loss as follows (R. 39–40): He prorated the cost ($3,414,345.63) of Artemas Ward, Inc. (N. Y.) between the New York and Delaware corporations on the basis of their net worth as of the time of reorganization. Thus, the stock of the Delaware corporation was given a base of $2,634,041.66 and the stock of the New York corporation a base of $780,303.97. The base of the stock of the New York corporation was reduced by $234,967.21 (which had been distributed to United Brokerage Company), leaving a net base of $545,336.76. By subtracting the sale price of that stock ($49,640) from the net base, the Commissioner determined a loss of $495,696.76.

The Board of Tax Appeals approved the Commissioner's determination, and its judgment was affirmed by the Circuit Court of Appeals.

ARGUMENT

Article 1599 (2) of Regulations 69, promulgated under Section 203 (c) of the 1926 Act, *infra*, originally provided:

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[2] Another issue, involving the determination of the proper basis for computing gain or loss on the cancellation of a certain contract, was decided below adversely to the taxpayer. The petition for certiorari, however, states that no review of that question is sought (Pet. 3, note).

> Where the stock distributed in reorganization is in whole or in part of a character or preference materially different from the stock in respect of which the distribution is made, the cost or other basis of the old shares of stock shall be divided between such old stock and the new stock in proportion, as nearly as may be, to the respective values of each class of stock, old and new, at the time the new shares of stock are distributed, and the basis of each share of stock will be the quotient of the cost or other basis of the class with which such share belongs, divided by the number of shares in the class. *The portion of the cost or other basis of the old shares of stock to be attributed to the shares of new stock shall in no case exceed the fair market value of such shares as of the time of their distribution.* (Italics supplied.)

The italicized portion was deleted by T. D. 4274, promulgated November 19, 1929,[3] VIII–2 Cumulative Bulletin 240.

The Commissioner applied the amended regulation, apportioning the $3,414,345.63 basis of the original stock between the old and new shares in proportion to the value of the 4,964 old shares and the 100 new shares at the time of the reorganization (December 31, 1925). The result was a new basis of $780,303.97 for the old stock, which, when diminished by the amount distributed after reorgani-

[3] This change was first made in T. D. 4144, issued on April 3, 1928 (VII–1 Cumulative Bulletin 55), but T. D. 4274 was the final revision.

zation ($234,967.21), left a net basis of $545,336.76. Thus, upon sale of the 4,964 shares for $49,640, the Commissioner allowed a loss of $495,696.76.

The petitioners do not challenge the correctness of the Commissioner's computations under the amended regulation. Nor do they assert that the amended regulation is unreasonable or in conflict with the statute. They contend, however, that the Commisisoner was without authority to apply the amended regulation to a transaction already consummated, and that he should have applied the regulation in its original form, which would have resulted in a $2,167,785.56 loss.[4]

Authority to apply the amended regulation is founded upon Section 1108 (a) of the 1926 Act, as amended by Section 605 of the 1928 Act:

> In case a regulation or Treasury decision relating to the internal revenue laws is amended by a subsequent regulation or Treasury decision, made by the Secretary or by the Commissioner with the approval of the Secretary, such subsequent regulation or Treasury decision may, with the ap-

[4] Under the original regulation the basis of the new stock could not exceed its market value at the time of distribution, namely, $961,952.86. Thus, if that amount be deducted from the original basis ($3,414,345.63), the new basis of the old stock would be $2,452,392.77. Accordingly, a loss of $2,167,785.56 would result upon deducting the $234,967.21 accounts receivable subsequently distributed and the amount realized from the sale of the old shares ($49,640).

proval of the Secretary, be applied without retroactive effect.

This section obviously contemplates that amended regulations shall normally be given universal application, both prospective and retrospective, since special permission is required to apply them with exclusively prospective effect. Amended regulations under the income tax laws have been repeatedly applied to govern transactions fully consummated before. *Murphy Oil Co.* v. *Burnet*, 287 U. S. 299, 303–304; *Burnet* v. *S. & L. Bldg. Corp.*, 288 U. S. 406, 410; *Titsworth* v. *Commissioner*, 73 F. (2d) 385 (C. C. A. 3d); *Champ Spring Co.* v. *United States*, 47 F. (2d) 1, 2 (C. C. A. 8th), certiorari denied, 283 U. S. 852. See also *Bamberger* v. *Commissioner*, 27 B. T. A. 785, disposed of by stipulation, 67 F. (2d) 983 (C. C. A. 10th).

Neither the statute nor the decisions distinguish in this respect between what the petitioners term "interpretive" and "legislative" regulations. The cases cited above negative any such distinction. Thus, in the *Murphy Oil Co.* case the regulation prescribed the method of allocating depletion to bonus and royalties; in the *S. & L. Building Corporation* case, the method of allocating profits upon the installment sale of mortgaged property; and in the *Titsworth* case, as in the case at bar, the method of apportioning the cost basis of stock retained after reorganization. In each instance the statute

left to the Commissioner the determination of the formula, and the formula applied was promulgated after the transactions in question were completed. We submit, therefore, that the amended regulation rather than the original regulation was properly applicable to the transactions herein.

Arizona Grocery Co. v. *Atchison Ry.*, 284 U. S. 370, is not authority to the contrary. In that case the Interstate Commerce Commission was denied the power retroactively to change a maximum reasonable rate previously fixed. But there no statutory provision comparable to Section 1108 (a) existed acknowledging the power to make such amendments. Cf. *Great Northern Ry.* v. *Sunburst Co.*, 287 U. S. 358.

Nor is the retroactive operation of the amended regulation unconstitutional. Retroactive income tax laws have received continued judicial sanction. *Brushaber* v. *Union Pacific Railroad Co.*, 240 U. S. 1, 20; *Lynch* v. *Hornby*, 247 U. S. 339, 343; *Hecht* v. *Malley*, 265 U. S. 144, 164; *Updike* v. *United States*, 8 F. (2d) 913 (C. C. A. 8th); *Phipps* v. *Bowers*, 49 F. (2d) 996 (C. C. A. 2d). The retroactivity is even less questionable where the new provision does not impose a new tax but merely changes the basis for computing gain or loss. *Cooper* v. *United States*, 280 U. S. 409.

CONCLUSION

The decision below is correct. There are no conflicting decisions. The petition should be denied.

Respectfully submitted.

STANLEY REED,
Solicitor General.
FRANK J. WIDEMAN,
Assistant Attorney General.
JAMES W. MORRIS,
ARNOLD RAUM,
Special Assistants to the Attorney General.

AUGUST 1935.

APPENDIX

Revenue Act of 1926, c. 27, 44 Stat. 9:

SEC. 203. * * *

(c) If there is distributed, in pursuance of a plan of reorganization, to a shareholder in a corporation a party to the reorganization, stock or securities in such corporation or in another corporation a party to the reorganization, without the surrender by such shareholder of stock or securities in such a corporation, no gain to the distributee from the receipt of such stock or securities shall be recognized. * * * (U. S. C. App., Title 26, Sec. 934.)

SEC. 204. (a) The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; except that—

* * * * *

(9) If the property consists of stock or securities distributed after December 31, 1923, to a taxpayer in connection with a transaction described in subdivision (c) of section 203, the basis in the case of the stock in respect of which the distribution was made shall be apportioned, under rules and regulations prescribed by the Commissioner with the approval of the Secretary, between such stock and the stock or securities distributed; * * *.

(U. S. C. App., Title 26, Sec. 935.)

Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 605. RETROACTIVE REGULATIONS.

Section 1108 (a) of the Revenue Act of 1926 is amended to read as follows:

"SEC. 1108. (a) In case a regulation or Treasury decision relating to the internal-revenue laws is amended by a subsequent regulation or Treasury decision, made by the Secretary or by the Commissioner with the approval of the Secretary, such subsequent regulation or Treasury decision may, with the approval of the Secretary, be applied without retroactive effect."

(U. S. C. Supp. VII, Title 26, Sec. 1691.)

Treasury Regulations 69, promulgated August 28, 1926:

ART. 1599. *Stock or securities distributed in reorganization.*—In the case of stock or securities acquired by a shareholder after December 31, 1923, in connection with a transaction described in section 203 (c) and article 1576, the basis in the case of the stock in respect of which the distribution was made shall be apportioned between such stock and the stock or securities distributed to the shareholder. The basis for the old and new shares shall be determined in accordance with the following rules:

* * * * *

(2) Where the stock distributed in reorganization is in whole or in part of a character or preference materially different from the stock in respect of which the distribution is made, the cost or other basis of the old shares of stock shall be divided between such old stock and the new stock in proportion, as nearly as may be, to the respective values of each class of stock, old and new, at the time the new shares of stock are

distributed, and the basis of each share of stock will be the quotient of the cost or other basis of the class with which such share belongs, divided by the number of shares in the class. The portion of the cost or other basis of the old shares of stock to be attributed to the shares of new stock shall in no case exceed the fair market value of such shares as of the time of their distribution.

This Article was amended by T. D. 4144, VII–1, Cumulative Bulletin 55, promulgated April 3, 1928, by striking out the last sentence of Paragraph (2) thereof. It was further amended by T. D. 4274, VIII–2, Cumulative Bulletin 240, 241–242, promulgated November 13, 1929, in which Paragraph (2) was made to read as follows:

> Where the stock distributed in reorganization is in whole or in part stock in a corporation a party to the reorganization other than the distributing corporation, or where the stock distributed in reorganization is in whole or in part stock of a character or preference materially different from the stock in respect of which the distribution is made, or where the distribution consists wholly or partly of securities other than stock, the cost or other basis of the stock in respect of which the distribution is made shall be apportioned between such stock and the stock or securities distributed in proportion, as nearly as may be, to the respective values of each class of stock or security, old and new, at the time of such distribution, and the basis of each share of stock or unit of security will be the quotient of the cost or other basis of the class of stock or security with which such share or unit belongs, divided by the number of shares or units in the class.

Within the meaning of the foregoing provision, securities are different in class from stocks, stocks or securities in one corporation are different in class from stocks or securities in another corporation, and, in general, any material difference in character or preference or terms sufficient to distinguish one stock or security from another stock or security so that different values may properly be assigned thereto, will constitute a difference in class.

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v.

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ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT

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OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 27–35)[1] is reported in 29 B. T. A. 395. The opinion

[1] The records have been separately printed. However, the cases were consolidated before the Board of Tax Appeals

of the Circuit Court of Appeals (R. 45–53) is reported in 76 F. (2d) 892.

JURISDICTION

The judgments of the Circuit Court of Appeals were entered April 22, 1935 (R. 60). A petition for rehearing was denied May 22, 1935 (R. 64). The petition for writs of certiorari was filed July 8, 1935, and was granted October 14, 1935. (R. 67.) The jurisdiction of this Court rests on Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Under Regulations 69, Article 1599, as originally promulgated *August 28, 1926,* where stock distributed to a shareholder in reorganization of the distributing corporation was of a different character from that of the distributing corporation, the cost basis of the old shares was to be divided between such old stock and the new stock in proportion to the respective values of the old and new stock at the time the new was distributed; *provided*, that the portion to be attributed to the new shares should in no case exceed the fair market value of such shares as of the time of their distribution. On *April 3, 1928,* the original regulation was amended by striking out the *proviso* clause.

(see *Record in Manhattan General Equipment Company case*, p. 1), and disposed of in a single opinion both in the Board of Tax Appeals and in the Circuit Court of Appeals. Unless otherwise indicated, references to the record are to the record in the *Manhattan General Equipment Company case*, No. 226.

The question presented is whether the regulation as amended was properly applied to measure the gain or loss on sale by a stockholder in *December, 1926,* of shares of old stock where the stockholder in *December, 1925,* had received, on a reorganization, distribution of shares in another corporation without surrender of the old shares.

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved appear in the Appendix, *infra.*

STATEMENT

During the year 1926, the petitioners were affiliated with United Brokerage Company and a number of other corporations. A consolidated return for that year was filed on their behalf by United Brokerage Company and the Commissioner determined therefrom the proportion of the tax which should be assessed against each of them (R. 18–22).

On June 30, 1925, the total capital stock (4,964 shares of common) of one of the affiliates, Artemas Ward, Inc., a New York corporation, was acquired by United Brokerage Company at a cost of $3,414,345.63 (R. 23). On December 31, 1925, the total net assets of Artemas Ward, Inc., had a fair value of $1,246,920.07 (R. 24). On that date, Artemas Ward, Inc., transferred all its assets, with the exception of cash and accounts receivable aggregating $284,967.21, to another corporation of the same name organized under the laws of Delaware. The

net value of the assets so transferred was, therefore, $961,952.86 (R. 24–26). In exchange the Delaware corporation issued all its capital stock (100 shares) to the New York corporation (R. 24).

Immediately thereafter, on the same day, the New York corporation distributed to its sole stockholder, United Brokerage Company, the 100 shares of stock of the Delaware corporation, together with accounts receivable aggregating $234,967.21. Thus: "All of the assets of the New York corporation were taken from it with the exception of $50,000 in cash, so that the 4,964 shares were backed by nothing more than $50,000 in cash. The 100 shares of Delaware corporation stock were backed by practically all of the remaining assets which had formerly belonged to the New York corporation" (R. 34)—and the net value of those assets was $961,952.86. (R. 24–34.)

In December 1926 United Brokerage Company, in two transactions, sold to one George B. Anderson, an outsider, all of its stock (4,964 shares) in the New York corporation for $49,640 (R. 10, 24–25). The sole question involved in this case relates to the method for computing the loss on that sale.[2]

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[2] Another issue, involving the determination of the proper basis for computing gain or loss on the cancellation of a certain contract, was decided below adversely to the taxpayer. The petition for certiorari, however, states that no review of that question is sought (Pet. 3, note).

In the consolidated return filed by United Brokerage Company, in the petitions to the Board of Tax Appeals, and in the proceedings before it, a deduction of $3,062,314.54 was claimed as a loss resulting from the sale of the stock in the New York corporation through the application—not of subdivision (2) of Article 1599, Regulations 69, of August 28, 1926, for which petitioners now contend (Br. 7–8)—but of subdivision (1) thereof (R. 3, 10, 14, 25, 33, 34, 40). Petitioners for the first time invoked, as an alternative to the use of subdivision (1), the application of subdivision (2) of Article 1599, Regulations 69, of August, 1926, in their petitions for review of the decision of the Board of Tax Appeals by the Circuit Court of Appeals (R. 42).

Following Article 1599 (2) of Regulations 69, as amended (see Appendix, *infra*), the Commissioner computed the loss as follows (R. 26): He prorated the cost ($3,414,345.63) of Artemas Ward, Inc. (N. Y.), between the New York and Delaware corporations on the basis of their net worth as of the time of reorganization. Thus, the stock of the Delaware corporation was given a base of $2,634,041.66, and the stock of the New York corporation a base of $780,303.97. The base of the stock of the New York corporation was reduced by $234,967.21 (which had been distributed to United Brokerage Company), leaving a net base of $545,-336.76. By subtracting the sale price of that stock

($49,640). from the net base, the Commissioner determined a loss of $495,696.76 (R. 26).

The Board of Tax Appeals ruled against petitioners' contention for the application of subdivision (1) of Article 1599, and approved the Commissioner's determination, holding subdivision (1) unreasonable as applied to the situation before it (R. 33, 34); and its decision was affirmed by the Circuit Court of Appeals on the ground that the method of apportionment required by subdivision (2) of Article 1599, Regulations 69, as amended, was not unreasonable and that the Commissioner had the right to apply it to the 1926 transaction because the Regulations were tentative and applicable retroactively to the date of the law (1926) under which promulgated (R. 50–53).

SUMMARY OF ARGUMENT

The applicable statute (Sec. 204 (a) (9) Rev. Act 1926) prescribes that the basis shall be "apportioned" between the old stock and the new stock distributed; and to "apportion" means to divide proportionately. The amended regulation equitably operates under the statute and reaches the result contemplated by it.

The application of the original regulation in this case would conflict with the statute and produce an unreasonable result because it would not apportion or divide the basis proportionately between the old and the new stock. Hence, even should it be deemed legislative in character, it was inapplicable.

The Commissioner was authorized to amend regulations to apply retroactively in order to carry out the intent of the statute and the amendment was a correct administrative interpretation of the statute.

ARGUMENT

Section 203 (c) of the Revenue Act of 1926, *infra*, provides that no gain or loss shall be recognized under the situation presented, and Section 204 (a) (9), *infra*, provides that, on the sale or other disposition of such stock:

> the basis in the case of the stock in respect of which the distribution was made shall be *apportioned*, under rules and regulations prescribed by the Commissioner with the approval of the Secretary, *between such stock and the stock or securities distributed* * * * (Italics supplied.)

On August 28, 1926, the Commissioner promulgated Article 1599 of Regulations 69, *infra*. This regulation (subdivision (1)) provided one rule where all of the stock distributed in reorganization was of substantially the same character or preference as the stock held, and this was the rule which petitioners sought to apply prior to their petition for review by the Circuit Court of Appeals, as heretofore noted. It provided (subdivision (2)) another rule where the new stock was of a different preference. The petitioners now apparently concede that where the new stock is stock of a different corporation it is to be regarded as stock of a dif-

ferent character or preference, even though both are common stock, and insist that apportionment should be made not under the first but under the second rule as originally promulgated as follows:

> Where the stock distributed in reorganization is in whole or in part of a character or preference materially different from the stock in respect of which the distribution is made, the cost or other basis of the old shares of stock shall be divided between such old stock and the new stock in proportion, as nearly as may be, to the respective values of each class of stock, old and new, at the time the new shares of stock are distributed, and the basis of each share of stock will be the quotient of the cost or other basis of the class with which such share belongs, divided by the number of shares in the class. *The portion of the cost or other basis of the old shares of stock to be attributed to the shares of new stock shall in no case exceed the fair market value of such shares as of the time of their distribution.*[3] (Italics supplied.)

This rule was first amended April 3, 1928, by T. D. 4144, VII–1 Cumulative Bulletin 55, which struck out the italicized sentence.[4]

In this case, the Commissioner and the Board have applied the amended rule; that is, the cost of

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[3] Article 1599, Regulations 65 promulgated October 6, 1924, contained substantially the same language.

[4] The final revision was made in T. D. 4274, VIII–2 Cumulative Bulletin 240, promulgated November 13, 1929, in which the sentence italicized above was also omitted.

the old stock ($3,414,345.63) has been apportioned between the old and new shares in proportion to the value of the 4,964 shares of old stock in the New York corporation and the 100 shares of new stock in the Delaware corporation at the time of the distribution of the new stock, December 31, 1925 (R. 26). By this means, the Commissioner has determined a cost basis of $545,336.76 for the old stock and has ascertained a loss of $495,696.76, the difference between the basis and the selling price.

The petitioners now argue that the second rule of Article 1599 must be applied in the form in which it appeared in the original regulation and hence that the apportionment is subject to the requirement that the portion of the cost allocated to the new shares of the Delaware corporation shall not exceed their fair market value at the time of their distribution, $961,952.86. This would leave the remainder of the cost of the old stock, $2,452,392.77, to be allocated to the old stock of the New York corporation, which had transferred most of its assets to the Delaware corporation. A loss of $2,167,785.56 would thereby be established, instead of the $495,696.76 allowed by the Commissioner (Br. pp. 4–5). This result is as palpably unreasonable as applied to this case as the conclusion reached under the original theory that subdivision (1) of Article 1599 applied, and of which the Board of Tax Appeals said (R. 34):

> It is to be regretted that such a regulation was published and allowed to stand for so many years, but, if the petitioner's contention is correct, the case demonstrates the unreasonableness of that regulation. All of the assets of the New York corporation were taken from it with the exception of $50,000 in cash, so that the 4,964 shares were backed by nothing more than $50,000 in cash. The 100 shares of Delaware corporation stock were backed by practically all of the remaining assets which had formerly belonged to the New York corporation. The net value of these assets was almost a million dollars, yet, under the petitioner's method, $3,111,954.54 of the original basis would be attributed to the New York stock and only $67,423.88 of the basis would be allocated to the Delaware stock.

Section 204 (a) (9), *infra,* provides that the cost basis of the stock shall be *apportioned,* under rules and regulations prescribed by the Commissioner with the approval of the Secretary, *between such stock and the stock or securities distributed.* The Congress must have used the word apportion in its ordinary sense. There is nothing in the statute to indicate that it was used otherwise. The definition of apportion as given in Webster's International Dictionary is "to divide and assign in just proportion; to divide and distribute proportionally." The statute contemplates, therefore, that the cost basis of the old stock shall be proportionally divided be-

tween the old and the new, so that it is the duty of the Commissioner to determine the respective values of the old and the new stock at the time of the reorganization and then to assign to each its proportionate share of the original cost of the old stock. In no other manner can the mandate of the Congress be carried out. The statute vests in the Commissioner no legislative authority. Under it he may not declare the law, since the Congress has already declared it. All the Commissioner is authorized to do is to find certain facts and then apply the law as the Congress enacted it. It is clear that the Commissioner under the authority of this section could not make a regulation providing for a method of apportionment which would ascribe to any given stock a proportion to other stock which it does not mathematically and inherently bear. His authority is merely to interpret the law and then apply it to the facts as he finds them.

Whether the original regulation be termed legislative or interpretive in character its application to the case at bar would be unreasonable and to that extent unauthorized. A statement of the facts demonstrates this. The stock of the old corporation cost United Brokerage Company $3,414,345.63. On the date of the reorganization the assets had a value of $1,246,920.07. Through the reorganization the old corporation was denuded of all of its assets except $50,000 in cash. The stock of the old corporation backed only by the $50,000 cash was

then sold for $49,640. The remainder of the assets of the old corporation amounting to $1,196,920.07 still remained under the control of United Brokerage Company. If the original regulation should be applied to these facts the petitioners would be entitled upon the sale for $50,000 of assets having a cost basis of only about $150,000 to realize a loss for income tax purposes of approximately $2,167,785.56.

A reorganization such as is involved here is not a taxable transaction and it is clear that the statute was not primarily designed to afford taxpayers the opportunity of realizing losses for income tax purposes. The purpose of the reorganization statute is to permit taxpayers to reorganize corporations without realizing a gain for income tax purposes. To permit a taxpayer, after denuding a corporation of practically all of its assets and selling the remaining few assets, to realize a loss for income tax purposes measured by the difference between the original cost of the entire stock of the corporation and the price obtained for the stock after taking from the corporation practically all of its assets, would permit a method of computation which would not clearly reflect the income and would not be within the statute. It would permit the realization of an enormous loss where in fact there was only a small loss.

Had the Commissioner, for example, promulgated a regulation providing that in no case should the new stock be given a value of more than ten

per cent of the cost of the old, it would be unauthorized and could not be applied unless the proportion chanced to be a correct one. So, when the Commissioner made the regulation providing that in no case should the value of the new stock exceed its market value, a computation based thereon would have been unreasonable and unauthorized if in fact the true proportion was greater or less than the market value. Such a regulation is nothing more than a formula and this Court has long held that formulae are nothing more than suggestive guides. *Minnesota Rate Cases,* 230 U. S. 352, 434; *Standard Oil Company of New Jersey* v. *Southern Pacific Company,* 268 U. S. 146. If the application of a formula produces a reasonable result its application will be sustained by the courts. If the result obtained is unreasonable it is beyond the power of the Commissioner to apply the formula. *Murphy Oil Company* v. *Burnet,* 287 U. S. 299; *Titsworth* v. *Commissioner,* 73 F. (2d) 385 (C. C. A. 3rd). It is established that the Secretary of the Treasury cannot by his regulation alter or amend a revenue law. *Morrill* v. *Jones,* 106 U. S. 466, 467. It is elementary that a regulation which amends, alters, or extends such a statute is void. *Lynch* v. *Tilden Company,* 265 U. S. 315, 321. In *Burnet* v. *Chicago Portrait Company,* 285 U. S. 1, 16, this Court pointed out that:

> The Court is not bound by an administrative construction, and if that construc-

> tion is not uniform and consistent, it will be taken into account only to the extent that it is supported by valid reasons.

In this case there are no valid reasons to support the original regulation. Although it might not be unreasonable as applied to some cases, its application would produce an unreasonable result in the instant case. It was the duty of the Commissioner in this case to apportion the old and the new stock to the original cost of the old stock. That is what he did under the amended regulation. Had he followed the original regulation he could not have done so, since the limitation contained therein would have prohibited the allocation to the new stock of an amount of the original cost in excess of its market value and would not permit apportionment to the new stock of the just proportion of the original cost of the old stock. Application of the original regulation, therefore, would have been unreasonable and would have produced an absurd result in conflict with the statute.

The case of *Arizona Grocery* v. *Atchison Railway,* 284 U. S. 370, relied upon by the petitioners is not in point. There Congress gave the Interstate Commerce Commission the power to fix reasonable and lawful rates. Acting under that power the Commission, after investigation, determined the maximum rate on a given commodity between two specific points and subsequently attempted to change its order retroactively. The Court held

that the exaction of unreasonable rates by a public carrier was forbidden by the common law; that the Congress had altered the common law by lodging in the Commission the power theretofore exercised by the courts of determining the reasonableness of rates; that when the Commission had established a maximum rate it was subject to the same tests as to its validity as would be an Act of Congress intended to accomplish the same purpose, and that the Commission was without authority to make a retroactive change in its order directing the carrier to make reparation to shippers.

The distinctions between the *Arizona* case and the case at bar seem plain. The *Arizona Grocery* case involved a statute wherein Congress had delegated to the Commission the power to establish maximum rates. The Commission, acting thereunder, made a finding of fact in a specific instance and then established a maximum rate to apply thereto. The order issued by the Commission on that finding of fact became a rule of conduct for the carrier. Contracts were made on the strength of that order and the rights and liabilities of the carrier with respect to third parties became fixed. In the instant case the Congress has not authorized the Commissioner to lay taxes. The Congress itself has laid the taxes and has delegated no other legislative functions to the Commissioner. The regulation involved was not based on a specific finding of fact but was merely a general interpretation of the

statute. Cf. *Gt. Northern Ry.* v. *Sunburst Co.*, 287 U. S. 358. There are no third parties involved and no rights have become vested.

It is elementary that the interpretation of a statute by an executive officer cannot change the law whether the interpretation be correct or erroneous. When an officer of the United States discovers that he has wrongfully interpreted a statute it is his duty thereafter to apply the statute in accordance with its terms to all cases coming before him regardless of whether they arose under the erroneous interpretation (see Board of Tax Appeals opinion, R. 34), except as he may be otherwise directed by Congress. Apparently such has long been the construction placed by the Treasury Department on internal-revenue laws. See I. T. 2152, IV–1, Cumulative Bulletin 83; S. M. 2216, III–2, Cumulative Bulletin 370. Congress has recognized this construction in many instances. Section 1314 of the Revenue Act of 1921, Section 1008 (a) of the Revenue Act of 1924, and Section 1108 (a) of the Revenue Act of 1926 all vested in the Commissioner, with the approval of the Secretary of the Treasury, discretionary power to apply amended regulations or Treasury decisions without retroactive effect unless the change was occasioned by a court ruling. Further recognition by Congress that interpretive regulations have a universal effect is found in Section 1108 (a) of the Revenue Act of 1926, as amended by Section 605 of the Revenue Act of 1928, which provides that:

> In case a regulation or Treasury decision relating to the internal-revenue laws is amended by a subsequent regulation or Treasury decision, made by the Secretary or by the Commissioner with the approval of the Secretary, such subsequent regulation or Treasury decision may, with the approval of the Secretary, be applied without retroactive effect.

The fact that Congress found it necessary to authorize the Secretary to approve a solely prospective application of the regulations is a clear indication that Congress recognized the universal character of such regulations. In fact, in explaining Section 506 of the Revenue Act of 1934, which further amended section 1108 (a) of the Revenue Act of 1926, the legislative committees stated that "Regulations, Treasury Decisions, and rulings which are merely interpretive of the statute, will normally have a universal application," and concluded that it was desirable to lodge in the Treasury Department the power to apply certain regulations with prospective effect only. H. Rep. No. 704, 73rd Cong., 2nd Sess., p. 38; S. Rep. No. 558, 73rd Cong., 2nd Sess., p. 48.

Amended regulations made under the income-tax laws have been repeatedly applied to govern transactions fully consummated before. *Murphy Oil Company* v. *Burnet,* 287 U. S. 299, 303–304; *Burnet* v. *S. & L. Bldg., Corp.,* 288 U. S. 406, 410; *Bamberger* v. *Commissioner,* 27 B. T. A. 785, dis-

posed of by stipulation, 67 F. (2d) 983 (C. C. A. 10th).[5] In the *Murphy Oil* case the regulation prescribed the method of allocating depletion to bonus and royalties. In the *S. & L. Bldg. Corp.* case the regulation prescribed the method of allocating profits from the installment sale of a mortgaged property. The regulations involved in those two cases which were similar to the regulations involved in the case at bar, were applied retroactively by the Commissioner and his action was approved by this Court. In the *Bamberger* case the regulation, as in the instant case, prescribed the method of apportioning stock after a reorganization. The Commissioner applied the regulation retroactively and his action was approved by the Board of Tax Appeals.

In *Langstaff* v. *Lucas,* 9 F. (2d) 691 (W. D. Ky.), affirmed on the reasoning of the District Court, 13 F. (2d) 1022 (C. C. A. 6th), certiorari denied, 273 U. S. 721, the court made this pertinent observation as to a retroactive change in Treasury regulations (p. 693):

> * * * it would seem axiomatic that if, under the law, the transfer did result in tax-

[5] *Larkin* v. *United States*, 78 F. (2d) 951, 955 (C. C. A. 8th), contains a statement that regulations, as statutes, are not to be applied retroactively without a clear indication that this was intended. However, the question in that case and also in the case cited as authority (*Shearer* v. *Anderson*, 16 F. (2d) 995 (C. C. A. 2nd)) was whether a regulation made under a subsequent revenue act was applicable to a prior revenue act.

> able income to the plaintiff, any erroneous interpretation of the act by the Treasury Department would not estop the government from asserting the tax, even though the taxpayer may have been misled by such interpretation. He must have known that his tax liability was determined by the law, and not by what some administrative official thought was the law. We must therefore determine what constituted taxable income under the act of 1918. * * *

The petitioners state that had the Commissioner promulgated in the first instance the amended regulation, which he now seeks to apply, the United Brokerage Company could have effected the reorganization in a manner which would have permitted the realization of most of the losses now claimed. This contention seems to be inconsistent with the position assumed by the petitioners throughout the proceeding before the Board of Tax Appeals wherein they contended for the application of subdivision (1), Article 1599 of Regulations 69 promulgated August 28, 1926. Since they asserted the case to be under subdivision (1), it is difficult to see how now they can contend that in the reorganization they relied upon subdivision (2) of the regulation.

CONCLUSION

The decision below is correct and should be affirmed.

Respectfully submitted.

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JANUARY 1936.

APPENDIX

Revenue Act of 1926, c. 27, 44 Stat. 9, 12, 14:

SEC. 203. * * *

(c) If there is distributed, in pursuance of a plan of reorganization, to a shareholder in a corporation a party to the reorganization, stock or securities in such corporation or in another corporation a party to the reorganization, without the surrender by such shareholder of stock or securities in such a corporation, no gain to the distributee from the receipt of such stock or securities shall be recognized.

* * * * *

SEC. 204. (a) The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; except that—

* * * * *

(9) If the property consists of stock or securities distributed after December 31, 1923, to a taxpayer in connection with a transaction described in subdivision (c) of section 203, the basis in the case of the stock in respect of which the distribution was made shall be apportioned, under rules and regulations prescribed by the Commissioner with the approval of the Secretary, between such stock and the stock or securities distributed;

* * * * *

Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 605. RETROACTIVE REGULATIONS.

Section 1108 (a) of the Revenue Act of 1926 is amended to read as follows:

"SEC. 1108. (a) In case a regulation or Treasury decision relating to the internal-revenue laws is amended by a subsequent regulation or Treasury decision, made by the Secretary or by the Commissioner with the approval of the Secretary, such subsequent regulation or Treasury decision may, with the approval of the Secretary, be applied without retroactive effect."

Treasury Regulations 69, promulgated August 28, 1926:

ART. 1599. *Stock or securities distributed in reorganization.*—In the case of stock or securities acquired by a shareholder after December 31, 1923, in connection with a transaction described in section 203 (c) and article 1576, the basis in the case of the stock in respect of which the distribution was made shall be apportioned between such stock and the stock or securities distributed to the shareholder. The basis for the old and new shares shall be determined in accordance with the following rules:

* * * * *

(2) Where the stock distributed in reorganization is in whole or in part of a character or preference materially different from the stock in respect of which the distribution is made, the cost or other basis of the old shares of stock shall be divided between such old stock and the new stock in proportion, as nearly as may be, to the respective values of each class of stock, old

and new, at the time the new shares of stock are distributed, and the basis of each share of stock will be the quotient of the cost or other basis of the class with which such share belongs, divided by the number of shares in the class. The portion of the cost or other basis of the old shares of stock to be attributed to the shares of new stock shall in no case exceed the fair market value of such shares as of the time of their distribution.

This article was amended by T. D. 4164, VII–1 Cumulative Bulletin 55, promulgated April 3, 1928, by striking out the last sentence of Paragraph (2) thereof. It was further amended by T. D. 4274, VIII–2 Cumulative Bulletin 240, promulgated November 13, 1929, in which Paragraph (2) was made to read as follows (p. 241):

Where the stock distributed in reorganization is in whole or in part stock in a corporation a party to the reorganization other than the distributing corporation, or where the stock distributed in reorganization is in whole or in part stock of a character or preference materially different from the stock in respect of which the distribution is made, or where the distribution consists wholly or partly of securities other than stock, the cost *or other basis of the stock in respect of which the distribution is made shall be apportioned between such stock and the stock or securities distributed in proportion, as nearly as may be, to the respective values of each class of stock or security, old and new, at the time of such distribution, and the basis of each share of stock or unit of security will be the quotient of the cost or other basis of the class of stock or security*

with which such share or unit belongs, divided by the number of shares or units in the class. Within the meaning of the foregoing provision, securities are different in class from stocks, stocks or securities in one corporation are different in class from stocks or securities in another corporation, and, in general, any material difference in character or preference or terms sufficient to distinguish one stock or security from another stock or security so that different values may properly be assigned thereto, will constitute a difference in class. (Italics supplied.)

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Supreme Court of the United States

OCTOBER TERM, 1935

MANHATTAN GENERAL EQUIPMENT COMPANY,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

No. 226

COLLIER SERVICE CORPORATION,
formerly BROADWAY SUBWAY ADVERTISING CO., INC.,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

No. 227

PETITION FOR REHEARING

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Supreme Court of the United States

OCTOBER TERM, 1935.

MANHATTAN GENERAL EQUIPMENT COMPANY, Petitioner, vs. COMMISSIONER OF INTERNAL REVENUE, Respondent.	No. 226.
COLLIER SERVICE CORPORATION, formerly BROADWAY SUBWAY ADVERTISING CO., INC., Petitioner, vs. COMMISSIONER OF INTERNAL REVENUE, Respondent.	No. 227.

PETITION FOR REHEARING.

TO THE HONORABLE THE CHIEF JUSTICE AND THE ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

Come now MANHATTAN GENERAL EQUIPMENT COMPANY and COLLIER SERVICE CORPORATION, the petitioners in the above-entitled causes, by their counsel, and respectfully present this petition for a rehearing of the points discussed in the opinion handed down in said causes on February 3, 1936, and state the following reasons in support thereof:

I.

Your petitioners respectfully say that the original form of Article 1599, Subdivision 2, of Treasury Regulation 69, as promulgated on August 28, 1926, furnishes the applicable

rule for determining the loss suffered on the sale of 4,964 shares of stock of Artemas Ward, Inc. (N. Y.).

These 4,964 shares of Artemas Ward, Inc. (N. Y.) were not obtained in a tax-free reorganization, but were the original shares purchased by petitioners in 1925.* Their basis for tax purposes is determined by the generic rule of Section 204(a), that the basis for gain or loss from the sale of property is at cost, except in so far as otherwise provided in the succeeding subdivisions of that section. None of the succeeding subdivisions provides any basis to be used upon the disposition of the old shares of stock of Artemas Ward, Inc. (N. Y.), for the subdivision—Section 204(a) (9)—upon which the Commissioner has relied as creating an exception to the rule of Section 204(a) reads:

> *"If the property consists of stock or securities distributed after December 31, 1923, to a taxpayer in connection with a transaction described in subdivision (c) of section 203,* the basis in the case of the stock in respect of which the distribution was made shall be apportioned, under rules and regulations prescribed by the Commissioner with the approval of the Secretary, between such stock and the stock or securities distributed; * * *."

The shares of Artemas Ward, Inc. (N. Y.) disposed of by the petitioner in the case at bar were acquired by *purchase* and not in connection with a transaction described in subdivision (c) of Section 203. The provisions of Section 204(a) (9) are, therefore, inapplicable to these shares, since the statute prescribes an apportionment of the basis between the old and the new stock *only* if the property sold consists of stock or securities acquired in connection with a tax-free reorganization. There are no *casus omissi* in Section 204(a). If no exceptions to it cover the transaction, *ex hypothesi* the general rule of Section 204(a) will govern.

The petitioners concede that because of the receipt of the new shares of stock, altering the nature of the investment from shares of Artemas Ward, Inc. (N. Y.) to shares in both

* The 100 shares of Artemas Ward, Inc. (Delaware) acquired in the reorganization were retained by the petitioner.

the New York and Delaware corporations, some abatement had to be made in the basis of cost for the old shares, and part of such cost allocated to the new shares. Otherwise, if the old stock were, as was here the case, sold first, no portion of the investment cost would have been attributed to the new shares, and when the new shares were subsequently sold they would have a basis of zero, despite the fact that Section 204(a) (9) expressly provides that upon the sale of the new shares they should be given a basis derived by apportionment of the cost. Thus, two utterly diverse and unrelated methods for determining gain or loss would be employed, depending on whether the new or the old shares of stock were first sold.

Mindful of the restrictions upon his authority to deviate from the basis provided for the old shares in Section 204(a), and in order to reconcile this section with Section 204(a) (9) by means of a uniform method for determining the basis of the new or old stock irrespective of which were first sold, the Commissioner, in his promulgation of Article 1599 of Treasury Regulations 69 in its original form, set the maximum of the cost to be attributed to the basis of the new shares at their fair market value at the time of distribution, reserving the balance of the cost to the old shares.

It cannot be gainsaid that this method harmonized the rules prescribed by Sections 204(a) and 204(a) (9) and effectuated the intention of Congress that Section 204(a) and its subdivisions be construed as an integrated system for the determination of bases.

Petitioners submit that the Commissioner was without statutory warrant in departing from his original cost-basis of the old stock, for no regulation would be consistent with Section 204(a) which failed to limit to the market value of the new stock the deduction from the basis of the old stock.* At least in so far as the basis of the old stock was concerned, a reduction of its basis by a greater amount would have been tantamount to an abandonment of the rule laid down by

* It is submitted that the reduction of the basis of cost under Section 204(a) by an amount greater than the fair market value of the new shares would have been objectionable as unreal and at variance with a business man's expectations.

Congress in Section 204(a). And as was said by Mr. Justice Sutherland in the instant case:

> "The power of an administrative officer or board to administer a federal statute and to prescribe rules and regulations to that end is not the power to make law—for no such power can be delegated by Congress—but the power to adopt regulations to carry into effect the will of Congress as expressed by the statute. A regulation which does not do this, but operates to create a rule out of harmony with the statute, is a mere nullity. *Lynch* v. *Tilden Co.*, 265 U. S. 315, 320-322; *Miller* v. *United States*, 294 U. S. 435, 439-440, and cases cited."

Because of the catastrophic decline in the value of the original shares prior to the reorganization, any method of apportioning the cost between the old and the new shares would yield a basis for the old shares which, at first sight, might appear unduly large. This, however, is merely a natural result of the existence of a loss unrealized at the time of the reorganization, and could only be avoided by assigning a greatly inflated basis to the new shares.

II.

The Commissioner in assailing the validity of his own regulations should be in no better position than a taxpayer. *Cf. Brewster* v. *Gage*, 280 U. S. 327, 336; *Fawcus Machine Co.* v. *United States*, 282 U. S. 375.

Article 1599 of Treasury Regulations 69, as originally promulgated, was intended to prevent the utilization by the distributee of a basis for his new stock greater than the fair market value at the time of acquisition. That reconsideration after all the returns were in revealed that a disproportionate basis for old shares might result if their market value had declined before reorganization, is not probative of the unreasonableness of the limiting sentence of Article 1599 of Regulations 69, which provided:

> "The portion of the cost or other basis of the old shares of stock to be attributed to the shares of new stock shall in no case exceed the fair market value of such shares as of the time of their distribution."

In view of the Congressional direction in Section 204(a) (9) that the Commissioner promulgate regulations, it would have been in contravention of the legislative purpose to postpone their issuance beyond a reasonable time, particularly as their effect would be to endow the section with meaning. It is clear that the regulations were to be issued before the close of the calendar year, and to that extent to be prospective in operation. Regulations whose issuance is delayed until after the expiration of the taxable year or which are amended several years later, are subject to being impugned as self-serving declarations made *post litem motam*.

Congress itself may not retroactively tax already completed transactions (*Untermyer* v. *Anderson*, 276 U. S. 440; *Nichols* v. *Coolidge*, 274 U. S. 531; *Helvering* v. *Helmholz*, 296 U. S. 93; *Hudson* v. *United States*, 12 Fed. Supp. 620), and even in the case of the income tax only a limited retroactivity has been attempted by Congress or been upheld by this Court. See *Cooper* v. *United States*, 280 U. S. 409, 412. Moreover, whatever may be said of the power of the Commissioner to amend retroactively his regulations with respect to the basis to be assigned to the new shares (*Cf. United States* v. *Davis*, 132 U. S. 334), it is submitted that the same reasoning will not justify his departure from the express language of Section 204(a). As applied to the old stock, the original regulation was not so contrary to law or so unreasonable that it should not be recognized as a valid regulation. It differs in this vital respect from *Titsworth* v. *Commissioner*, 73 Fed. (2d) 385.

It is respectfully urged upon the foregoing grounds that this petition for a rehearing and opportunity for reargument be granted.

Respectfully submitted,

LAURENCE GRAVES,
Counsel for Petitioners.

February 27, 1936.

Certificate of Counsel.

I, LAURENCE GRAVES, counsel for the above-named MANHATTAN GENERAL EQUIPMENT COMPANY and COLLIER SERVICE CORPORATION, do hereby certify that the foregoing petition for rehearing of these causes is presented in good faith and not for delay.

LAURENCE GRAVES,
Counsel for Petitioners.

SUPREME COURT OF THE UNITED STATES.

Nos. 226 and 227.—October Term, 1935.

Manhattan General Equipment Company, Petitioner, 226 *vs.* Commissioner of Internal Revenue. Collier Service Corporation, formerly Broadway Subway Advertising Co., Inc., Petitioner, 227 *vs.* Commissioner of Internal Revenue.	On Writs of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

[February 3, 1936.]

Mr. Justice Sutherland delivered the opinion of the Court.

These cases involve identical facts and questions of law, and were disposed of by the court below in one opinion. 76 F. (2d) 332. The facts, so far as they concern the question here, are taken from the statement of that court.

The petitioners are affiliates of United Brokerage Company. That corporation filed income tax returns for itself and its affiliates for 1925 and 1926 and the petitioners seek to review tax deficiencies attributed to them by the Commissioner, which the Board of Tax Appeals has affirmed. . . .

On June 30, 1925, the United Brokerage Company purchased for $3,414,345.63 in cash all the capital stock of Artemas Ward, Inc., [a New York corporation] that was issued and outstanding consisting of 4,964 shares of no par value. . . .

On December 31, 1925, pursuant to a plan of reorganization, Artemas Ward, Inc. (N. Y.) transferred to Artemas Ward, Inc. (a Delaware corporation), in exchange for 100 shares of stock of the latter company of no par value, all its assets, then of a net book value of $1,246,920.07, with the exception of cash and accounts receivable aggregating $284,967.21—that is to say, the New York corporation transferred to the Delaware corporation assets of the value of $961,952.86. Immediately after the transfer, and on December 31, 1925, Artemas Ward, Inc. (N. Y.) distributed to United Brokerage Company the 100 shares of stock of Artemas Ward, Inc. (Del.) and accounts receivable amounting to $234,967.21. In December, 1926, United Brokerage sold the entire 4,964 shares of Artemas Ward, Inc. (N. Y.) for $49,640. That stock had cost the United Brokerage $3,414,345.63 and the total must

be apportioned between the 100 shares of the Delaware corporation (which it still owns) and the 4,964 shares of Artemas Ward, Inc. (N. Y.) in order to determine the loss suffered by the United Brokerage Company through its sale of the 4,964 shares at $49,640.

Upon the reorganization, the New York corporation had left among its assets, valued at $1,246,920.07, accounts receivable and cash aggregating $284,967.21, or approximately 22.85% thereof, after $961,952.86 had been transferred to the Delaware Company. Under Art. 1599 (2) [as amended, *infra*,] the portion of $3,414,345.63 paid by the United Brokerage Company for the stock of Artemas Ward, Inc. (N. Y.) represented by that stock after the reorganization was $780,303.97. If from this be deducted $234,967.21 accounts receivable and the $49,640 realized from the sale in December, 1926, there would be a loss of $495,696.76. This loss the Commissioner allowed in assessing the income tax for 1925. The second point raised on this appeal is whether the loss, for the year 1926, to which the United Brokerage Company and its affiliates were entitled was only the sum of $495,696.76 or was the sum of $2,167,785.56 which would arise through deducting from $3,414,345.63, (the cost of the stock of the New York company) the value at the time of the reorganization of the Delaware stock which was $961,952.86 and $234,967.21 realized from accounts receivable and $49,640 realized from sale of the 4,964 shares.

It thus appears, the New York company having parted with all its assets except $50,000 in cash, that the assets behind the 4,964 shares when the 100 share distribution was made consisted of only that sum, while the 100 shares of the Delaware company stock was represented by the transferred assets of the New York company of the value of $961,952.86. The sale of the 4,964 shares brought $49,640; and the simple question to be determined is what method for the purposes of taxation should be employed to determine the loss in respect of the 4,964 shares under the Revenue Act of 1926, § 204 (a) (9), c. 27, 44 Stat. 9, 14, 15. That section provides that the basis for determining the gain or loss from such sale shall be the cost of the property, except that—

"(9) If the property consists of stock or securities distributed after December 31, 1923, to a taxpayer in connection with a transaction described in subdivision (c) of section 203,* the basis in the

*Sec. 203 (c) provides: "If there is distributed, in pursuance of a plan of reorganization, to a shareholder in a corporation a party to the reorganization, stock or securities in such corporation or in another corporation a party to the reorganization, without the surrender by such shareholder of stock or securities in such a corporation, no gain to the distributee from the receipt of such stock or securities shall be recognized."

case of the stock in respect of which the distribution was made shall be apportioned, under rules and regulations prescribed by the Commissioner with the approval of the Secretary, between such stock and the stock or securities distributed; . . . ''

At the time of the reorganization, Article 1599 of Treasury Regulations 69, which had been promulgated on August 28, 1926, was in force. Petitioners invoke subdivision 2 of that regulation which provided:

''Where the stock distributed in reorganization is in whole or in part of a character or preference materially different from the stock in respect of which the distribution is made, the cost or other basis of the old shares of stock shall be divided between such old stock and the new stock in proportion, as nearly as may be, to the respective values of each class of stock, old and new, at the time the new shares of stock are distributed, and the basis of each share of stock will be the quotient of the cost or other basis of the class with which such share belongs, divided by the number of shares in the class. *The portion of the cost or other basis of the old shares of stock to be attributed to the shares of new stock shall in no case exceed the fair market value of such shares as of the time of their distribution.*'' (Italics added.)

April 3, 1928, this regulation was amended by striking from it the italicized portion. The taxpayer contended that its loss should be computed in accordance with the original regulation. This would have resulted in an allocation to the 4,964 shares of the New York corporation of $2,452,392.77; and, after making certain deductions, the allowable loss, as already appears, would have been something over $2,000,000. The commissioner, however, proceeding in strict accordance with the amended regulation, determined the amount of loss to be $495,696.76. Without pursuing the matter in further detail, it is enough to say that the case turns entirely upon the question whether the loss was to be determined in accordance with the original or the amended regulation. If in accordance with the former, the taxpayer is right; if in accordance with the latter, the commissioner is right. The court below held that the amended and not the original regulation furnished the applicable rule, and affirmed the determination of the Board of Tax Appeals, which in turn had sustained the commissioner. We agree with that view.

In determining a loss, the statute requires that the basis shall be ''apportioned'' between the old and the new stock. To appor-

tion is to "divide and assign in just proportion", "to distribute among two or more a just part or share to each," *Fisher* v. *Charter Oak Life Ins. Co.*, 14 Abb. N. C. 32, 36, albeit, a division may be just without necessarily being also an exactly equal division. The result of applying the original regulation here is to bring about an inequitable apportionment, contrary to the intent of the statute, and to credit the taxpayer with a loss essentially and greatly disproportionate. On the other hand, application of the amended regulation effectuates the legislative intent that the basis of apportionment between the old and the new stock shall result in a fair and just division.

The power of an administrative officer or board to administer a federal statute and to prescribe rules and regulations to that end is not the power to make law—for no such power can be delegated by Congress—but the power to adopt regulations to carry into effect the will of Congress as expressed by the statute. A regulation which does not do this, but operates to create a rule out of harmony with the statute, is a mere nullity. *Lynch* v. *Tilden Co.*, 265 U. S. 315, 320-322; *Miller* v. *United States*, 294 U. S. 435, 439-440, and cases cited. And not only must a regulation, in order to be valid, be consistent with the statute, but it must be reasonable. *International Ry. Co.* v. *Davidson*, 257 U. S. 506, 514. The original regulation as applied to a situation like that under review is both inconsistent with the statute and unreasonable.

The contention that the new regulation is retroactive is without merit. Since the original regulation could not be applied, the amended regulation in effect became the primary and controlling rule in respect of the situation presented. It pointed the way, for the first time, for correctly applying the antecedent statute to a situation which arose under the statute. See *Titsworth* v. *Com'r of Int. Rev.*, 73 F. (2d) 385, 386. The statute defines the rights of the taxpayer and fixes a standard by which such rights are to be measured. The regulation constitutes only a step in the administrative process. It does not, and could not, alter the statute. It is no more retroactive in its operation than is a judicial determination construing and applying a statute to a case in hand.

Judgment affirmed.